PRO-POOR ECONOMIC GROWTH RESEARCH STUDIES
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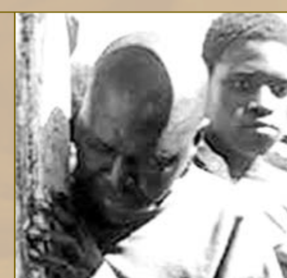
Pro-Poor Economic Growth: A Review of Recent Literature



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Pro-Poor Economic Growth: A Review of Recent Literature

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EXECUTIVE SUMMARY

Over the last three decades, the share of world population that is poor has declined significantly. The rate of decline has, however, slowed over the last two decades. Looking beyond global aggregates reveals that there is a wide variation in poverty rates (as measured by $1 per day poverty line) across countries and regions. Indeed, between 1970 and 1998, the poverty rate increased significantly in Africa while it decreased in Asia and Latin America.

These developments have sparked much discussion regarding the growth-promoting "Washington Consensus" and the related question of whether growth is sufficient everywhere to reduce poverty and ultimately to promote equitable development. The wide variance in poverty rates between countries exhibiting similar growth rates supports the notion that growth may be necessary but is not sufficient for maximum poverty reduction. Key questions for policy makers thus include: What factors cause such variations in poverty? How can these factors be harnessed to facilitate pro-poor growth? This paper examines the most significant policy and academic literature related to pro-poor growth to ascertain how pro-poor growth can be effectively promoted.

Much of the debate surrounding poverty reduction focuses on the relationship among inequality, economic growth, and poverty. Empirical evidence suggests that both growth and inequality have important effects on poverty reduction and that there are also important interactions between the two. For example, some studies show that inequality hinders growth. More specifically, economies that exhibit a high level of initial inequality grow less quickly and achieve less poverty reduction from the growth that does occur . This finding does not imply that inequality should be reduced by any means necessary. If inequality is reduced at the expense of growth, prospects for poverty reduction may be seriously harmed. The key to poverty reduction is thus to promote strategies that strike a balance between fostering growth and achieving greater equity. The strategy choice is critical because, if redistributing wealth to the poor comes at the cost of future growth, poverty reduction today may come at the price of greater poverty tomorrow.

The literature highlights the potential for policy to influence the level of inequality and pace of growth. Broadly speaking, policy areas can be identified that facilitate simultaneously the acceleration of growth and the spreading of incomes more evenly:

- **Expanding Basic Educational Opportunities.** An expansion in primary and lower secondary school achievement can accelerate economic growth and narrow income inequality. Conversely, initial expansion of elitist levels of education sharpens income disparities;

- **Expanding Access to Quality Primary Health Care and Combating Communicable Diseases;**

- **Reducing Biases against Agricultural Competitiveness,** including trade policy reforms, may be particularly effective in reaching the rural poor while enhancing overall efficiency under conditions of equitable access to land and other factors of production. However, where inequality is high in rural areas, even agricultural growth may do little to alleviate poverty;

- **Reforming Trade.** Removing biases against producing low-skill, labor-intensive manufactured exports in low-income countries directly raises the earnings of the urban poor;

- **Limiting Taxes and Labor Market Regulations that Raise Labor Costs Unduly**, encourages more efficient use of labor, and enables trade and other reforms to create jobs;

- **Improving the Poor's Access to Credit and Land and Other Natural Resources** and control over the natural resources;

- **Promoting Development Policies that Address the Direct Links among Poverty, Inequality, and Violent Conflict in Post-Conflict Environments.** In so doing, policies that target the poor and seek to minimize social and economic inequality should be promoted;

- **Vigorously Combating HIV/AIDS.** HIV/AIDS not only increases the scale and depth of poverty for sufferers, but also can significantly reduce growth at the sectoral and national levels by affecting labor productivity and overall production and domestic market demand; and

- **Promoting Public Workfare Programs and the Provision of Social Safety Nets in Cases of Transient Poverty Caused by Crises**. Transient poverty is a particularly important phenomenon in the context of short-term crises. For it is during these periods that families are at risk of either being thrown into poverty or falling deeper into it. The danger of transient poverty is that it may result in long-term indigence.

Finally, the new Washington Consensus—if it exists—is directly concerned with reducing poverty and has advocated decentralization as a tool to achieve this goal. There is no clear evidence that decentralization is an effective strategy for poverty reduction. As such, promotion of decentralization as a means for poverty reduction should be approached with caution.

The question of how to promote pro-poor growth is highly complex. As this literature review highlights, some tentative conclusions have been drawn with regard to the factors that must be considered in the design of appropriate pro-poor policies, but the debate is still unfolding. This literature review is intended to inform the further work of the Pro-Poor Economic Growth Research Studies Project. The project will produce a number of in-depth studies on topics dealing with the issue of how to achieve pro-poor growth. For a more detailed discussion of some of the topics covered in this review, please refer to the list of project deliverables printed on the inside cover of this document.

CHAPTER ONE
WASHINGTON CONSENSUS; WASHINGTON CONTENTIOUS

Twelve years ago, John Williamson coined the term Washington consensus “to refer to the lowest common denominator of policy advice being addressed by the Washington-based institutions to Latin American countries as of 1989.”[1] In the interim, this term has been much abused. In distancing himself from these abuses, a decade after coining the term Williamson writes, “The popular, or populist, interpretation of the Washington Consensus, meaning market fundamentalism or neoliberalism, ...the markets will resolve everything. I would not subscribe to the view that such policies offer an effective agenda for reducing poverty.”[2]

Today, it is not clear any consensus among Washington-based economists would be easy to discern, with respect to either the success of laissez-faire strategies in promoting development or the role of economic development in reducing poverty. In looking back, Joe Stiglitz notes that “The IMF and World Bank have changed their rhetoric—there is much more talk about poverty.”[3] This became evident in the World Development Report 2000. Yet even among the World Bank economists there remains fundamental disagreement over strategies for poverty reduction. On the one hand, Stiglitz maintains that “The World Bank’s main mission is to eradicate poverty, not so much by providing humanitarian assistance at the time of crisis as by enabling countries to grow.”[4] On the other hand, in *Beyond the Washington Consensus: Institutions Matter*, Javed Burki and Guillermo Perry argue that the reforms that made up Williamson’s original consensus had been successful in promoting growth in Latin America but “had not been equally effective in reducing poverty and inequality, which they argued demonstrated a ‘need to focus on improving the quality of investments in human development’.”[5]

If the distribution of income remains unaltered as development proceeds, it is tautological that poverty diminishes at higher levels of development. Consequently, much of the debate focuses upon the connections between income inequality and development. Nearly half a century ago, Simon Kuznets noted that Germany, the United Kingdom, and the United States appeared to have transited from relative equality at an earlier stage in their economic development, through episodes of greater inequality, to again become more egalitarian societies in recent times.[6] This pattern became known as Kuznets’s curve. In Chapter Three, some of the explanations that have been offered for this pattern will be reviewed as well as some of the more recent evidence on the persistence of such a pattern. However, in the last decade a new focus has emerged. In this line of literature, rather than looking at the effect of the level of economic development on inequality, the association is turned around to look at the effect of inequality on growth. Some plausible reasons for this new focus that have been

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1 Williamson (2000) p.251. The term was apparently introduced in Williamson (1990).
2 Williamson (2000) p.257.
3 Stiglitz (2002) p.215.
4 Stiglitz (2002) p.224.
5 Williamson (2000) p.260. Williamson quotes from Burki and Perry (1998) p.4.
6 Kuznets (1955).

proffered in recent literature are summarized in Chapter Two, together with the related evidence. The evidence proves mixed; some authors find that more unequal countries grow less quickly while others seem to report the opposite. Chapter Two therefore attempts to cut through these seeming contradictions.

Together, the two branches of literature provide a scenario in which the level of development affects inequality and inequality affects the speed of development. Not surprisingly, it becomes difficult to identify the separate effects of these closely knit forces. Even more important, if this were all, it would be unclear where policy interventions might break into this cycle of effects. Yet in practice, these patterns prove far from highly deterministic. Exceptions are the norm and the source of contention. Chapter Four therefore turns to look at the evidence, in the recent literature, on the role of policy in a range of areas in shaping departures from the norm. Some policies may help to accelerate growth while enhancing the share of the poor; a win-win situation for poverty reduction. Far more difficult choices arise when redistribution strategies threaten to retard growth, forcing a choice between poverty reduction today or greater poverty reduction tomorrow.

Most of the literature reviewed in Chapters Two through Four is concerned with long-term patterns of growth and development. Chapter Five turns to look at some aspects of shorter term fluctuations in these secular patterns. The 1990s witnessed a series of financial crises, following a plethora of more structural crises in the 1980s. Superimposed on this, individual families face crises more randomly dispersed. Whatever the source, crises can result in sharp increases in transient poverty. It is less clear how often this transient poverty translates into chronic poverty. Chapter Five asks what the literature tells us about mechanisms for coping with such transient poverty. Chapter Six examines the relationship among conflict, inequality, and poverty. This chapter concludes with a discussion of post-conflict policies that promote pro-poor growth. Chapter Seven focuses on HIV/AIDS and its links to poverty and growth and, in particular, pro-poor growth.

Finally, before concluding in Chapter Nine, Chapter Eight addresses another new focus that has attracted the attention of some of the Washington-based institutions in the last decade. Much attention and even lending have shifted from national to sub-national governments. What does the recent literature tell us about whether decentralization is pro-poor?

CHAPTER TWO
THE EFFECT OF INEQUALITY ON GROWTH

If economies that have greater inequality grow more slowly, the incidence of poverty is not only greater in these economies at any given level of average income but the speed of transition out of poverty is also diminished by the slower growth. The evidence on whether greater inequality retards growth, or not, proves contentious. Arguments have certainly been put forward as to why the causation may go in either direction. This chapter, therefore, starts with a brief summary of some of these major arguments before turning to the conflicting evidence.

LINES OF ARGUMENT

Barro (1999) distinguishes four main groups of ideas as to why more unequal economies tend to grow more or less quickly: the traditional argument based on different savings rates, arguments that emphasize credit market constraints, political economy arguments, and the role of social unrest.

Although many macro-economists today are skeptical that marginal savings rates rise with the level of income, the traditional belief in such a relationship led to suggestions that greater inequality in incomes would enhance the overall savings rate and hence, perhaps, stimulate investment and accelerate growth. In contrast, stories that emphasize credit constraints are more ambiguous in their predictions. For example, poor families might enjoy high returns on educating their children but cannot afford to take advantage of this. In this case, redistribution to the poor may increase high return investments in education and accelerate growth. Yet, "For instance, formal education may be useful only if carried out beyond some minimal level. One possible manifestation of this effect is the apparently strong role for secondary schooling, rather than primary schooling, in enhancing growth...these considerations favor concentration of assets. Hence, this element tends to generate positive effects of inequality on investment and growth."[7] Either way, "If capital markets and legal institutions tend to improve as an economy develops, then the effects related to capital-market imperfections are more important in poor economies than in rich ones."[8]

It is typically hypothesized that greater inequality leads to more violence and instability, slowing growth. The only mitigating factor is that greater inequality may deny the poor the capacity to disrupt, partly by providing the rich with the resources to suppress. In contrast, the literature that has focused on the democratic process and the role of redistribution provides less clear anticipated effects.[9] In societies where the distribution of political power is more egalitarian than is the distribution of economic resources (as in a one-person-one-vote context), policies to redistribute incomes are more likely to be supported. If the process

[7] Barro (1999) p.2.
[8] Barro (1999) p.2
[9] See, for example, Perotti (1993), Alesina and Rodrik (1994), Persson and Tabellini (1994), Bénabou (1996).

of redistribution itself limits growth, through various disincentive effects of taxes and transfers, then greater economic inequality (before redistribution) may retard growth. However, countries that choose a path of greater redistribution may be observed with greater equality (after redistribution) and slower growth, which results from the act of redistribution.

Arguments can thus readily be made in both directions as to whether greater equality is likely to accelerate or retard growth. So what does the evidence show?

THE EVIDENCE

The evidence divides sharply between studies using cross-country data versus those examining within country patterns over time.

Most of the research that has looked at the effect of an initial measure of inequality in various countries on subsequent growth within those economies finds that greater inequality lowers growth. In surveying the literature in 1996, Bénabou notes that, of 13 studies using a variety of data sets and periods, 12 find such a negative association between inequality and growth (more or less significantly) and the remaining study finds no effect.[10] Moreover, "The magnitude of this effect is consistent across most studies: a one-standard-deviation decrease in inequality raises the annual growth rate of gross domestic product per capita by 0.5 to 0.8 percentage points. Whether this is large or small may be in the eye of the beholder. On the one hand, it amounts to between 30 and 45 percent of the standard deviation of growth rates found in most samples. It also implies an income gap of about 25 percent after 30 years, which is far from inconsequential. On the other hand, this does not come close to accounting for the growth differential observed between Korea and the Philippines or between East Asia and Latin America."[11]

As consistent as these studies are, the robustness of the results has been called into question by more-recent papers, based on data that enable systematic examination of a number of countries over time.[12] In essence, these papers find a positive relationship between changes in inequality and changes in the growth rate within their sample of countries; rising inequality accelerates growth.[13]

Both associations may exist simultaneously; within the typical country, there may be a positive relationship between inequality and growth over time; yet looking across these positive, within-country profiles at any moment, the cross-country pattern may be negative. From a policy perspective, a within-country time effect is normally considered more relevant.

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[10] See Bénabou (1996) Table 2. Clarke (1995) notes that greater inequality diminishes growth within both democracies and non-democratic societies.

[11] Bénabou (1996) p.13.

[12] Indeed, the robustness of results from this entire literature looking at cross-country evidence on growth performance, of which the inequality and growth literature is a sub-set, has been called into doubt. See Levine and Renelt (1992).

[13] Benhabib and Spiegel (1998), Forbes (1998), and Li and Zou (1998) each find such a positive association in a country-fixed-effects model of growth on inequality.

However, there are reasons to doubt both the positive results and any simple policy conclusion from them.

Some of these doubts arise from important non-linear patterns in the data that recent studies have identified. For example, Barro (1999) combines cross-country and time-varying data to find a negative relationship between inequality and growth among the poor countries and a positive relationship among the richer countries. The dividing point between these two scenarios in Barro's results is estimated to occur at a GDP per capita of about $2,000, measured in 1985 U.S. dollars. Unfortunately, the sample of countries that has led to the positive, within-country estimates is biased and as a result may be largely depicting the upper-income arm of the relationship reported by Barro.[14] A negative relationship, even within countries, certainly cannot then be ruled out among the lower-income countries. Certainly, the cross-country estimates of negative associations are encouraging for pro-poverty programs, presenting a win-win scenario; narrowing the income distribution to reduce poverty would apparently stimulate growth and hence further reduce poverty.

Banerjee and Duflo (2000) report yet another potentially important non-linear pattern in the data. In particular, they find that changes in inequality, in any direction, are associated with lower future growth rates. The authors remain agnostic about the causal interpretation of their finding but note that it is consistent with a scenario in which structural change, which is required to realize a growth potential, can be blocked by political groups demanding compensation for their losses. Whatever the causality, Banerjee and Duflo go on to show that this type of non-linear pattern means that the within-country estimates are essentially averages of both positive and negative effects, but the sample used in the within-country studies is biased toward the former.

This line of literature has been contentious and confusing. It is, however, probably fair to conclude in agreement with Martin Ravallion; "On balance, the existing evidence using cross-country growth regressions appears to offer more support for the view that inequality is harmful to growth than the opposite view, which was the prevailing view in development economics for decades. That does not imply, however, that any reduction in inequality will enhance growth; indeed, it can have the opposite effect if it comes at the expense of other factors that are also known to matter to growth."[15]

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[14] The reason for the bias lies in data availability. To examine changes within countries over time requires more than one (reliable) estimate of income distribution within the same country. Multiple estimates are not available for many of the lower-income countries.

[15] Ravallion (2001) p.1809.

CHAPTER THREE
INEQUALITY AND THE LEVEL OF DEVELOPMENT

The dispersion of incomes across families can be decomposed into three underlying contributing factors: the distribution of income-earning, productive inputs that belong to families, including labor as well as assets; the rates at which these different types of inputs are remunerated in the market; and the extent of income redistribution that takes place through taxes and transfers.[16] The outcome of the first two of these factors is the distribution of gross incomes in the market. Adding the third results in the distribution of net incomes. Most of our data on household incomes refer to gross incomes, although occasionally some public transfers may be included in the data. Some observers believe that data on household consumption may more fully reflect families' net incomes after redistribution.[17] Both measures have been used to examine Kuznets's curve.

The notion, underlying studies based on inequality in gross incomes, is that the dispersion of productive assets, or of market rewards to those assets, varies systematically with the level of development. If the inference is to net income inequality, the distribution of tax and transfer incidence may also vary systematically with development.

A number of suggestions have been made in the literature as to why any systematic pattern between the level of development and gross or net inequality might emerge. Kuznets's own speculations on the subject rely largely on cumulative urbanization as development proceeds. Kuznets argues that the rural sector is more egalitarian than the urban, industrial sector. Rural-to-urban migration then redistributes the population, not only from a low average income setting to one with a higher average but also to a context of greater income differentials. Kuznets also maintains that rural-to-urban migration does not suffice to close the gap in mean earnings between the two sectors as development proceeds, which might otherwise raise the incomes of the poor left in rural areas. Instead, Kuznets hypothesizes that at least part of the narrowing in income differences at higher levels of development may reflect upward mobility among subsequent waves of migrants.

Subsequent work revealed that some components of Kuznets's initial speculation are not essential to the story. In any dual economy, transfer of population from the sector with a low average income to the sector with an income that is maintained at a higher average will generate at least some forms of Kuznets's curve.[18] Neither greater inequality in the destination sector nor reduction in that inequality over time is essential to the process.[19]

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[16] To the extent that such rates vary across people or groups as a result of discrimination and other market imperfections, this creates another source of income variance; if the rate of remuneration for a given asset is correlated with the amount of that asset held (or more precisely, of all income-earning assets held), this interaction tends to further increase overall income variance.

[17] See the discussion in Deaton and Grosh (2000).

[18] See Robinson (1976), Knight (1976), and Fields (1979). See, however, Anand and Kanbur (1993) for a more general exposition.

[19] Indeed, the extent of upward mobility among migrants is the subject of some dispute. See the reviews in Borjas (1994), Lalonde and Topel (1997), and Lucas (2002b).

Interestingly, however, contributors to this literature have stressed alternative aspects of duality that may underlie Kuznets's curve. Knight and Sabot (1983) see the gap between incomes of the educated and uneducated as the key: as educational expansion occurs with development, Kuznets's curve is traced. Bourguignon and Morrison (1998) emphasize a "structural" gap in earnings between the agricultural sector and the remainder of the economy, which they relate to the gap in labor productivity between these sectors. Rauch (1993) also emphasizes a structural earnings gap, although in this case the emphasis is on the gap between the formal and informal sectors and the latter encompasses an urban informal sector as well as agriculture. Greenwood and Jovanovic (1990) model two classes of families: one with access to a well-functioning credit market, whereas the other is credit constrained; as development proceeds, the proportion in the former grows and Kuznets's pattern emerges. In contrast, Bourguignon and Morrison (1990) eschew a dualistic framework and consider instead a framework in which the distribution of assets plays a central role, while rewards to those assets are shaped by trade policy.

These contributions suggest (and even identify) different components of policy as playing key roles in changes in inequality over time. Policies that shape the distribution of education, alter labor productivity in agriculture, affect structural gaps in earnings, influence access to credit, or set protection levels in trade are all suggested as potentially important. By themselves, estimates of the relationship between inequality and the level of economic development cannot reveal the role played by these separate policy areas. Nonetheless, it is worth pausing to review the state of available estimates before turning to look at some of the policy areas in the following chapter.

THE EVIDENCE

The more recent explorations of the Kuznets relationship have enjoyed access to increasingly rich data sets, encompassing a wider range of countries, with multiple time period observations on inequality in a significant portion of those countries. Deininger and Squire (1998) explore a newly assembled data set that represents a substantial advance on the scope of previous data. Barro (1999) exploits both the cross-country and the time series aspects of these same data and finds clear support for Kuznets's pattern noted more than 40 years earlier.[20] Barro's estimates imply "that the Gini value rises with GDP for values of GDP less than $1,636 (1985 U.S. dollars) and declines thereafter."[21] Deininger and Squire (1998) similarly discern a Kuznets's curve in their data, although they also note that this apparent pattern is far from robust: "For example, addition of a regional dummy variable for Latin American observations makes the 'Kuznets curve' vanish… suggesting that the cross-sectional result may be affected by middle-income countries from Latin America that are characterized by relatively high inequality."[22] In contrast, when Barro exploits the fuller time series potential of these data and not merely their cross-country patterns, he finds that the

[20] Supporting evidence is also provided in Mushinski (1999) and Thornton (1999).
[21] Barro (1999) p.25. This refers to the panel estimates with no control variables as reported in Table 6.
[22] Deininger and Squire (1998) p.278.

Kuznets's curve patterns are robust to the introduction of not only a dummy variable representing Latin America but also to a substantial range of other controls too.[23]

The growing availability of panel data on income distribution, across time and across countries, permits not only pooled estimates of the type explored by Barro but also examination of changes in inequality within the average country. Here, the results are different. Both Deininger and Squire (1998) and Barro (1999) discern no significant pattern between changes in the level of inequality and changes in GDP per capita within countries.

At least three explanations are possible for the contrasting results in looking across countries and time, versus looking within countries: (1) As in the examination of the effect of inequality on growth, the sample of countries for which multiple (reliable) observations on inequality are available may be biased. (2) Our measures of inequality are always subject to a good deal of error. In looking at the changes in these measures within countries, the statistical noise from these errors may simply come to dominate the results so that no pattern is discerned. (3) Both patterns could be entirely correct; it is perfectly feasible that the currently middle-income countries tend, on average, to be more unequal (for reasons other than their level of development); yet the typical country may not follow any discernible pattern of inequality as development proceeds.

At present, we cannot be sure which of these explanations is correct. However, it is important to note that both approaches—both cross-country and within country—typically leave a good deal of variation in inequality unexplained, after the estimated effect of the level of development is taken into account. Even if average country experience involves a Kuznets process, there is nothing inevitable about this pattern.

ECONOMIC VERSUS HUMAN DEVELOPMENT

The Human Development Index, published annually in the UNDP *Human Development Report*, attempts to provide a summary measure of the quality of human life across a wide range of countries. In essence, the index is usually a composite of average income, educational attainment measures, and life expectancy. Whereas enhancing educational attainment and prolonging life may be admirable goals, forcing these measures into a single index adds little insight at best and occasionally conveys bizarre implications as a result of the weighting scheme imposed on the components.[24]

Leaving the index itself aside, however, the *Human Development Reports* convey a potentially important message. There clearly are aspects of the quality of human life that are not measured as part of family income or consumption, and some of these aspects are closely related to poverty. However, the *Human Development Reports* go further, arguing that economic growth (growth in measured incomes) has a tendency to worsen the non-economic

[23] One such control explored by Barro and others is for the type of data used in measuring inequality. Data on consumption (perhaps reflecting net income distribution) tend to display less inequality than do data on gross incomes, for example. See also Higgins and Williamson (1999).

[24] See, for example, the discussion of the implied value of human life in Ravallion (1997a).

aspects of human development unless actively checked. "Determined efforts are needed to avoid growth that is jobless, ruthless, voiceless, rootless, and futureless."[25]

The evidence, once again, is somewhat mixed. Kakwani (1993) analyzes data from 80 developing countries between 1971 and 1990 on two related variables, infant mortality and life expectancy at birth, both of which are key reflections of the life expectancy component of the Human Development Index. Kakwani shows that the improvement in both measures, over time within countries, is positively related to both the rate of economic growth and the level of GDP per capita.[26] "Thus the declines in incomes which have occurred in many countries in Africa and Latin America in the 1980s would have both long-term and short-term effects which would substantially retard progress in the standard of living."[27]

Easterly (1999) is far less sanguine about the role of economic development in improving living standards. He examines a much broader range of issues, relying on 95 indicators covering seven aspects of the quality of life: individual rights and democracy, political instability and war, education, health, transport and communications, inequality across class and gender, and a set of indicators of crime and environmental quality. "Virtually all of these indicators show quality of life across nations to be positively associated with per capita income."[28] However, very few of them show a positive correlation with rising income, within countries over time. Easterly's findings are disquieting. However, four potential explanations may be offered. First, some of the variables (such as individual rights or political stability) are difficult to measure accurately. Second, the theoretical basis to expect some indicators, such as the incidence of democracy, to be positively associated with income is weak; democracy is hardly a normal commodity. Third, as Easterly notes, some aspects of living standards may improve with incomes only with a considerable lag; in this sense, the cross-country patterns may give a better indication of longer-term associations. Fourth, Easterly speculates on the possibility that world growth may be more important than home country growth for certain aspects of the quality of life, such as the incidence of war.

Easterly's findings within countries notwithstanding, there is a consensus that, on average, economic development contributes to human development. Even the background material accompanying the *Human Development Reports* supports this position. Yet there is also a good deal of noise surrounding these average relationships and perhaps this is the main message we should take from the *Human Development Reports*. Social policies, if well executed, may serve to improve the quality of human development at any given level of income. If these social policies also accelerate economic growth, the poor benefit. However, social policies that retard economic growth require much more soul searching because economic growth is the key to human development, on average.

[25] UNDP (1996) p.2. This passage is quoted and discussed in Ravallion (1997a).
[26] Aturupane, Glewwe, and Isenman (1994) confirm the former effect with respect to infant mortality, using a somewhat different approach and sample.
[27] Kakwani (1993) p.335.
[28] Easterly (1999) abstract.

SUMMING UP: DEVELOPMENT, INEQUALITY, AND POVERTY

There seems to be widespread agreement that the incidence of global poverty (the fraction of world population that is poor) has declined substantially in the last three decades. There is less agreement on the trend in the absolute headcount of poor persons. Table 1 reproduces estimates from one of the most recent computations, by Sala-i-Martin (2002), which is based on individual income distribution estimates for 125 countries.[29] According to these figures, the average annual decline in the world poverty rate between 1971 and 1998 amounted to 3.27 percent per year. However, it is clear from Table 1 that the rate of decline in this poverty rate measure was much greater in the 1980s than in the 1970s or 1990s. Moreover, population growth has meant that the headcount of the absolute number of people in poverty has declined less rapidly than the poverty rate. Nonetheless, Sala-i-Martin's estimates indicate that slowing population growth enabled an average annual decline of 1.36 percent in the world headcount of poverty in the 1990s, or 1.87 percent if a poverty line of $2 is adopted instead. However, the estimates of the poverty headcount prove sensitive to country coverage, data, methodology, and poverty line adopted. For example, using 122 surveys covering 67 developing countries, Chen and Ravallion (2001) report only a small decline in the absolute head count of poverty from 1987 to 1998, even when they use a poverty line comparable to Sala-i-Martin's $1 line. This finding agrees with Sala-i-Martin's estimates over the same period, although their rate of poverty is less than one-tenth of 1 percent. With a poverty line of $2, however, and in contrast to Sala-i-Martin, Chen and Ravallion estimate that the total number of people living below the $2 poverty line actually expanded at a little less than 1 percent per year from 1987 to 1998.

Table 1: Average Annual Reduction in World Poverty Rate and Headcount

Year	Average Annual Reduction (percent per year)	
	Poverty Rate	Poverty Headcount
1971-1998	3.27	1.56
1971-1979	2.30	0.38
1980-1989	4.53	2.79
1990-1998	2.84	1.36

Source: Sala-i-Martin(2002)

Whether the absolute number of poor in the world rose or fell during the 1990s is thus unsettled, but the fact that these aggregates hide enormous variation across countries and regions is clear. See, for instance, the poverty rate estimates from Sala-i-Martin (2002) reproduced in Table 2.

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[29] The data reproduced in Table 1 are based on a poverty line of $1 per day in 1985 U.S. dollars, although the trend is very similar if a $2 cut-off is adopted instead.

Table 2: Poverty Rates by Major Region and Year
($1 per day poverty line)

Region	Poverty Rate			
	1970	1980	1990	1998
Africa	0.222	0.234	0.286	0.405
Asia	0.224	0.158	0.063	0.017
Latin America	0.050	0.012	0.019	0.022

Source: Sala-i-Martin(2002)

The fact that the poverty rate increased substantially in Africa while declining in Asia immediately suggests that growth has a good deal to do with these differences. Both this norm and the incidence of exceptions are brought out well in Ravallion's results, which are summarized here in Table 3. Ravallion analyzes spells between household surveys in 47 developing countries.[30] During 57 percent of those spells, average household incomes rose. Among these growing economies, inequality increased in 53 percent of spells, whereas among the economies of declining average household incomes, inequality rose during 38 percent of cases. Not surprisingly, the sharpest decline in the poverty rate occurred during those spells in which average incomes rose and inequality declined; conversely, poverty rates rose sharply during those 16 percent of spells in which average incomes fell and inequality increased. Poverty tended to increase, despite decreasing inequality in those cases in which average incomes fell. More important, poverty did decline in the bulk of the cases in which average incomes grew, yet inequality increased.

Table 3: Median Annual Rate of Poverty Decline:
Spells of Rising and Falling Inequality; Rising and Falling Average Incomes

Spells of	Percent of Spells in which Average Income		Median Annual Rate of Poverty Decline(%): During Spells in which Average Income	
	Fell	Rose	Fell	Rose
Rising inequality	16	30	-14.3	1.3
Falling inequality	26	27	-1.7	9.6

Source: Ravallion (2001) Table 1.

It is clear from Table 3, however, that the rate of poverty reduction is slow when incomes grew but inequality increased. Indeed, as Ravallion (1997b) notes, the rate of poverty reduction may be so far reduced in high-inequality countries that there is a question of whether they will escape from their absolute poverty trap. This doubt stems from two disadvantages suffered by the high-inequality countries: first, the weight of evidence supports the position that high-inequality societies grow less rapidly; second, that for given growth

[30] The results in Ravallion (2001) Table 1, are "based on 117 spells between two household surveys covering 47 developing countries in the 1980s and 1990s. Poverty is measured by the % of the population living below $1/day at 1993 Purchasing Power Parity. Inequality is measured by the Gini index." (Ravallion, 2001, p. 1808 note a.)

rates, there is less poverty reduction in high-inequality settings, even if the income distribution does not become more unequal. The latter may be illustrated dramatically, simply by noting that, if inequality were so great that one person received all of the income, growth would not reduce poverty at all.

Both growth and inequality have important effects on poverty eradication, and there are also important interactions between the two. Growth in average incomes in a society with a very unequal income distribution is very slow to eradicate poverty; moreover, unequal economies enjoy slower growth. Inequality may, or may not, change systematically on average as the level of development varies. Yet it is clear from the evidence that there is a large degree of latitude in shaping the extent of inequality at any given level of development. Balancing strategies to promote growth and to achieve greater equality is the key to poverty eradication. In doing so, however, it is critical to recognize that the pursuit of one goal can limit achievement with respect to the other. Thus, in the end, perhaps three classes of policy packages may be distinguished:

- Policies that are able simultaneously to accelerate growth and to improve the relative lot of the poor obviously represent win-win situations for the poor.

- Policies that aim to accelerate growth but do not aim to improve the relative position of the poor can reduce poverty. However, such policy packages may reduce poverty at a very slow pace, especially in settings with high levels of inequality.

- Policy packages that aim at improving the relative position of the poor but come at the cost of growth present trade-offs, even for the poor. The choice is between a better position in the immediate future or perhaps an even better position further into the future as the economy grows.

What do we know about which types of policy strategies fit into which category?

CHAPTER FOUR
INEQUALITY AND DEVELOPMENT STRATEGY

In this chapter, key aspects of development strategy will be reviewed in light of the foregoing question. First, some general considerations are presented on the role of trade policy and the contentious issue of speed of reform. This is followed by a discussion of the distributional implications of privatization. Next, the closely related issue of the effect of the sectoral composition of economic growth on poverty eradication is taken up. Does trickle down development work? Some of the causes and implications of relatively high labor costs in the formal sector are discussed. Then the role of human capital (both education and health) in the literature on growth and poverty alleviation is reviewed. Land reform and the related issue of institutions and their relationships to pro-poor growth are examined. This is followed by a discussion of the relationship among microfinance, economic growth, and poverty. This chapter concludes with an examination of the impact of environmental policy on pro-poor growth.

TRADE LIBERALIZATION

Trade liberalization, or "getting prices right" has been a central element of the Washington consensus, both in Williamson's original version and in its revisionist form. The presumption was that free trade would significantly accelerate growth. Moreover, much of our standard trade theory suggests that import protection hurts the relatively abundant factor. In the low-income countries, unskilled labor is the abundant factor. To the extent that this standard trade theory is correct, by lowering real earnings of the less-skilled workers in the low-income countries, protection is then presumed to hurt the poor.

Many studies have tried to estimate the effects of trade policy on growth. A few studies have examined the effect of trade policy on inequality. Neither sets of evidence unambiguously support the consensus view. A principal difficulty lies in defining appropriate measures of less restrictive trade. For example, many authors have noted a positive correlation between GDP growth and openness to trade, where openness is measured by the volume of trade relative to GDP. However, the fraction of GDP traded is likely to depend upon the level of development and certainly varies inversely with the size of the country. More appropriate measures focus upon the degree of departure of domestic from international prices—attempting to weight differential tariffs in some fashion, to proxy the use of quantitative restrictions, or to undertake direct comparisons of prices. Unfortunately, the alternative measures exhibit little inter-correlation.[31] Harrison (1996) consequently takes an agnostic approach and seeks correlations between any of these measures and economic growth. Her results offer some broad, although mixed and often only statistically weak, support for small increments to growth from freer trade.

[31] See Pritchett (1996).

Although there is some consensus among trade economists that freer trade can often improve the efficiency of resource use, especially relative to the highly protected developing economies, whether freer trade will accelerate capital accumulation or technical change is far more unclear.[32] The experiences of the transition economies in the 1990s have also called into question the role of price reform, and hence trade policy, in enhancing efficiency at least in the short run. In a context where public enterprises with soft budgets dominate, contract enforcement is weak, or there is rapid inflation, the message from price signals is ignored, by-passed, or masked. It is therefore not entirely surprising that the effects of openness to trade on growth prove mixed.

Bourguignon and Morrison (1990) offer significant empirical support for the proposition that trade protection results in greater inequality.[33] In particular, in a cross-country comparison of 20 developing countries, they find that, countries in which the average rate of effective protection on manufacturing exceeds 30 percent, the income share of the poorest 40 percent of the population was about 2.5 percent less than in countries where this average protection was less than 30 percent. Conversely, the share of the richest 20 percent was about 3 percent greater, although this finding was very weak in statistical terms. In a broader sample of 43 countries, Birdsall and Londono (1997) report a positive association between the growth in manufactured exports and growth in incomes of the "poorest," although this would appear to be subject to the usual problems of defining openness in terms of trade volume, and the measure of the "poorest" remains unclear.[34] Exploring the same data set as Birdsall and Londono but using the very generic Sachs-Warner index of openness, Higgins and Williamson (1999) found that open economies possessed significantly lower Gini coefficients in the 1960s but not thereafter and for no period found the gap in income between the richest and poorest quintile to be significantly affected by the Sachs-Warner index of openness.[35] Moreover, once Higgins and Williamson proceed to look at changes in income distribution within countries, rather than across countries, they find no association at all between their measure of openness and inequality.

Even in contexts where free trade will ultimately benefit unskilled workers and help the poor, it is possible that poverty will worsen in the transition to free trade. The depth of unemployment endured during the transition and the duration of transition itself are likely to depend, inter alia, upon the extent of initial distortion, the prevalence of barriers to labor mobility, the state of the financial system, the institutional capacity to support reform, and the credibility of the reforms.[36] Perhaps it is not then surprising that there is a lack of clear

[32] See the review of arguments, both ways, in Harrison (1996).

[33] In reaching this result, the authors control for country differences in GDP, secondary schooling rate, whether agricultural and mineral exports each exceed 5 percent of GDP, and the relative roles of both small and medium-sized farms and firms.

[34] In contrast, Papanek and Kyn (1986), on a sample of 83 countries observed between 1952 and 1978, find no association between the volume of manufactured exports and either the Gini coefficient or the share of the poorest 40 percent. Larger exports of primary products were found to have a weak effect in exacerbating inequality, which the authors attribute to rents generated in the primary sector.

[35] For a definition of this index, see Higgins and Williamson (1999) p.13. Each economy is defined as open or closed. For example, all socialist economies are closed. However, tariff protection plays no role in defining the index.

[36] For a review of literature, see Rodrik (1995).

direction of change in inequality following trade policy changes within countries. Nonetheless, removing trade barriers that bias domestic production away from the use of unskilled labor will normally reduce income disparities over time while expanding production through more efficient use of resources. The cross-country evidence tends to reflect these longer-term effects, more frequently exhibiting greater equality with lower protection levels.

PRIVATIZATION

The majority of developing and transition countries began implementing neoliberal economic reforms in the 1990s. Privatization was promoted as a means by which governments could increase the efficiency and financial performance of the enterprises in question, relieve the massive drain on their coffers imposed by the state-owned enterprises and raise some funds, and increase the rate of investment and possibly economic growth.[37] Privatization has thus figured prominently in most reform efforts. Studies have shown that privatization has generally resulted in increased efficiency (Majumdar 1996, Frydman et al. 1999, Ramamurti 1997) and improved financial performance of privatized firms (D'Souza and Megginson 1999). In their literature review covering 65 countries, Megginson and Netter (2001) find that the studies they review offer at least "limited support for the proposition that privatization is associated with improvements in the operating and financial performance of divested firms" (p. 29). However, the impacts of privatization on growth, government budgets, employment in the privatized enterprises, and investment are not well established in the literature and its effect on wealth and income distribution has been disappointing.[38]

Although many countries have touted improved distributional equity as a goal of privatization, the majority of privatization programs have not explicitly tackled distributional issues.[39] This has resulted in a situation where "at least initially and on average privatization has *worsened* wealth distribution and income distribution" (Birdsall and Nellis 2002: 18).[40] Birdsall and Nellis posit that the negative wealth effects emerge as a result of transfer of ownership to the relatively well off (Stiglitz 1999, Newberry and Pollitt 1997),[41] the negative income effects that result from increased prices (Estache et al. 2001, Delfino and Casarin

[37] It is important to note that some critics of privatization argue that improved firm performance is a function of competition and deregulation rather than the change of firm ownership from public to private (Allen and Gale 1999; Tandon 1995).

[38] Studies examining the effect of privatization on employment levels generally focus on changes in employment in the privatized firms and not the economy as a whole.

[39] Some privatization programs (especially those in transition economies) used vouchers to address the issue of equity. The distributional impacts of voucher programs have generally been disappointing.

[40] Italics added.

[41] This conclusion is preliminary because it is drawn mainly from studies on transition economies of Eastern Europe and former Soviet Union.

2001), and job losses.[42] It must be recognized, however, that privatization has provided increased access to goods and services to all classes. For example, utility privatization has resulted in network expansion and increased access. This has mitigated to varying degrees the negative impact of privatization on the poor.

Although the process of privatization as implemented has generally had deleterious effects on the welfare of the poor, Birdsall and Nellis maintain that this outcome may not be inevitable. They point to the case of utility privatization in Bolivia and to 81 privatizations in Côte d'Ivoire that resulted in both increased efficiency and equity-enhancing outcomes for the poor. Although there are no conclusive studies regarding the proper strategies to apply to achieve both efficiency and equity, Birdsall and Nellis's study makes an important contribution by drawing attention to the fact that there does not have to be a tradeoff between efficiency and equity under privatization: privatization can produce a win-win outcome.

SECTORAL PATTERNS OF GROWTH: DOES TRICKLE DOWN WORK?

In the lower-income developing countries, most of the poor typically live in rural areas.[43] Thus, it is not surprising that there is substantial evidence that agricultural growth is positively correlated with poverty reduction. Much of this evidence has been amassed in the context of India.[44] There are, however, a few cross-country studies with broadly supporting evidence.[45] However, Timmer (1997) finds that, among the least egalitarian of the 27 developing countries in his sample, agricultural growth does little to reach the poorest quintile.

Even successful agricultural sectors normally grow more slowly than the non-agricultural sectors. A fundamental question then arises about the extent to which trickle-down effects, from urban-industrial development in the core, formal sector, can be relied upon to alleviate poverty, especially given the observation that most poverty is concentrated in rural areas (at least among the low-income economies). The answer to this question depends upon the nature of the context. It is therefore worth pausing to outline how any trickle-down process may conceivably operate, before turning to review the evidence.

Perhaps the chief route through which trickle-down development from the center may contribute to rural poverty reduction is through labor market adjustments. Labor migration to urban areas can, in principle, tighten rural labor markets, reducing underemployment and raising rural earnings.[46] A key parameter in determining the magnitude of this contributing

[42] The impact of privatization on employment levels, however, has not been clearly established. There are some methodologically innovative studies such as that by Galal, Jones, Tandon, and Vogelsang 1994, which by using counterfactuals find that privatization actually leads to increases in employment levels. However, there are also studies that arrive at the opposite conclusion, finding that privatization results in massive job losses (Ramamurti 1997; D'Souza and Megginson 1999). Thus, contrary to the fears of many governments, it appears that privatization does not *necessarily* result in massive employment declines.

[43] See, for example, the evidence in Lipton and Ravallion (1995).

[44] Ahluwalia (1978), Bell and Rich (1994), Ravallion and Datt (1996), Datt and Ravallion (1998a, 2002).

[45] See Timmer (1997) or Bourguignon and Morrison (1998), for example.

[46] For a more detailed review, see Lucas (1997).

factor is the labor intensity of urban growth; if only a few jobs are created by investments in capital-intensive activities, any potential for rural trickle down is minimized. Second, geography may also be important because most migrants move only relatively short distances. However, in many contexts, migration from small towns close to the metropolitan centers induces migration from more remote areas to these small towns.[47] Third, movement from rural to urban areas is typically dominated by young adults, and the propensity to migrate also rises among those with more education. Both factors serve to diminish any direct labor market effects on mature and unskilled adults in rural areas. Indeed, there is some danger that removal of the best and brightest young people may even harm those left behind in the rural areas through brain-drain effects, although this remains undocumented.

Besides any induced labor market effects, at least two additional sets of elements may be critical in influencing the extent of trickle-down development. The first set are any backward and forward linkages between the urban and rural sectors. For example, urban development may stimulate agricultural development through rising demand for food. However, this effect is likely to be small in contexts where local food crops are exported or are close substitutes for imported foods, in which case expanding urban food demands will have their chief impact on trade patterns rather than on domestic agricultural production. Nonetheless, backward linkages from industrial development can be important when agricultural raw materials are significant inputs into the manufacturing process.

The second additional set of elements shaping the extent of trickle down is composed of links retained between urban migrants and their home, rural areas. Transfers, remitted by migrants to their family at home, can represent an important source of support and security. The flow of such remittances need not be large, on average, to have an important impact; the mere potential of remittances may be sufficient to encourage rural families to undertake higher yielding, riskier investments.[48] However, remittances commonly tend to be greater to wealthier families at origin. When migration is also selective, with the educated children of wealthier families representing most of the movers, remittances may do little to alleviate poverty directly.[49] Besides remittances, a burgeoning literature notes three other routes through which out-migrants may benefit their home area: by stimulating trade, by encouraging third parties to invest, and by transferring technology. In each of these, it is ultimately the role of social networks created by migration that matters.[50]

In a series of papers, Gaurav Datt and Martin Ravallion examine poverty rates, across states and time in India, in relation to both agricultural and non-agricultural growth.[51] Datt and Ravallion (2002) estimate that, on average from 1960 to 1994, a 1 percent increase in real agricultural output per hectare of net sown area, within any given state, reduced the

[47] For a review of evidence and arguments see Lucas (2001a).
[48] See the arguments and evidence in Lucas and Stark (1985), Hoddinott (1994), and Schrieder and Knerr (2000).
[49] See Stark, Taylor, and Yitzhaki (1986) for contrasting evidence in two villages in Mexico, one with broad-based migration, the other with more selective migration.
[50] See Lucas (2001b) and Rauch (forthcoming) for discussions and evidence in the context of international migration. Bandiera and Rasul (2001) present evidence consistent with social networks having played a significant role in promoting new technology adoption in agriculture in northern Mozambique.
[51] Datt and Ravallion (1998b, 2002) and Ravallion and Datt (1996, 2002).

headcount of those below India's poverty line, within that same state, by nearly 0.2 percent.[52] Moreover, this rate of response did not vary significantly across the states of India. Meanwhile, the ratio of poverty reduction to within-state, nonagricultural growth per person is estimated to vary by state. The highest estimated response is in Kerala, where a 1 percent increase in nonagricultural output per person reduced the poverty headcount by more than 1.3 percent. The smallest estimated response is in Bihar, with a 0.26 percent reduction in the poverty headcount with each 1 percent growth in nonagricultural output per person.[53] Yet these same data indicate that growth in industrial production in India, from 1960 to 1994, had no significant effect in reducing overall poverty either in rural or in urban areas.[54] There are at least three contributing factors to this apparent contradiction. First, only a small part of the industrial growth was located in the states with the most poor people, so little was gained in reducing national poverty. Second, within the nonagricultural sector, the findings of Datt and Ravallion suggest it is tertiary sector expansion that contributes most to poverty reduction, not secondary sector growth. Third, industrial development in India during this period was extremely capital intensive, as a result of both trade and industrial licensing policies, and employment in the factory sector actually fell over a significant portion of the time.[55]

Nonetheless, Bourguignon and Morrison (1998) use cross-country data to find that the greater the ratio of value added per worker in agriculture to that in nonagricultural activities, the greater is the share of income going to the bottom 60 percent of households and the smaller is the share going to the top 20 percent. From these results, Bourguignon and Morrison conclude that "increasing the level of productivity in traditional agriculture may have become the most efficient way of reducing inequality and poverty."[56] Yet any such conclusion would be premature. First, any statement about efficiency implies that a dollar spent on poverty reduction would be more effectively spent on agricultural productivity improvements, which does not follow from the mere observation of any leverage effect of that productivity change. Second, this line of argument would suggest that raising labor productivity by adopting labor-saving methods in agriculture would serve to diminish poverty, which seems unlikely. Third, as emphasized in the previous two chapters, the effect on poverty reduction depends upon any effect on overall growth and on the relative share of the poor.

The results of Datt and Ravallion do suggest that trickle down from nonagricultural growth can contribute significantly to poverty reduction but that the magnitude of this effect varies systematically with certain initial conditions. For example, Datt and Ravallion (2002) find that the effect of nonagricultural growth on poverty reduction was greater in those states of India where the initial female literacy rate was higher and where the proportion of rural

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52 See Datt and Ravallion (2002) Table 3.

53 Note that these poverty reduction elasticities are not comparably defined and hence the numbers cannot be compared directly between the agricultural and non-agricultural sectors.

54 See Ravallion and Datt (1996) Table 3.

55 See Lucas (1989). By way of contrast, Lucas and Verry (1999) note the very rapid growth in manufacturing employment in Malaysia over the same time period. There is little question that this employment growth contributed to the substantial decline in both rural and urban poverty in Malaysia. By 1990, Lucas and Verry note that even the poorer, rural households in peninsular Malaysia had diversified very largely out of agriculture as a source of income.

56 Bourguignon and Morrison (1998) p.249.

households that were landless was lower. The prevalence of landless households may partly reflect greater overall initial inequality, which means that growth will do less to reduce poverty. Certainly, this finding on India is consistent with cross-country analyses, which also find that the rate of poverty reduction is lower for given growth rates where inequality in land ownership is greater.[57] The role of education is discussed on page 23, although literacy can certainly play a key role in promoting trickle-down effects, when literacy raises the likelihood of obtaining a job in the nonagricultural sector.

Meanwhile, a high level of import protection on manufactured goods has represented one chief source of bias against agriculture and its potential for poverty reduction in many of the developing economies. As development, capital accumulation, and technology acquisition proceed, comparative advantage in trade often turns against agriculture. At this stage, any policy to subsidize the livelihood of poor groups deriving their incomes from these declining activities can readily backfire, in effect locking these communities into a waning sector. Upward mobility for such groups may be more effectively achieved through diversification and transition into the newly expanding activities, for which education may be the key.[58]

A Note on Labor Costs

Although high earnings for workers are clearly desirable in their own right, artificially high labor costs can also encourage inefficient use of labor and may exacerbate poverty. Rising labor costs in the more formal sectors of the economy displace workers, who then compete for jobs elsewhere, driving down earnings in the less formal sectors. In the absence of an informal sector with sufficient flexibility to absorb the displaced workers, open unemployment results. Such scenarios offer a common justification for import restrictions, protecting relatively high paying jobs in import-competing industries. However, trade policy is clearly a clumsy instrument for dealing with what is essentially a labor market issue. Indeed, if the cause of the high labor costs is not well understood, trade protection may even worsen the situation.[59] In principle, it is also possible to lower labor costs to employers while retaining high take-home pay by subsidizing wage payments. Yet this option is rarely adopted because of the financial costs involved, the difficulties of effectively monitoring such schemes, and the complexity of determining an appropriate rate of subsidy.[60]

A major alternative is attempting to redress the forces that give rise to the high labor costs. For the most part, closing the gap in labor costs between the formal and informal sectors is likely to enhance the efficiency of labor use. Nonetheless, this may not always be the case so it is important to understand the root causes of the prevailing gaps. For example, arguments have been made in the literature as to why it may actually be efficient for employers to pay wages above the going rate in the informal sectors. In these efficiency wage theories, high

[57] See, for example, Birdsall and Londono (1997).
[58] See Lucas and Verry (1999) on subsidies to paddy farmers and fishermen in Malaysia.
[59] See, for example, the discussion of endogenous wage responses to protection in Rodrik (1987).
[60] Behrman (1986) examines the case of a wage subsidy on initial employment of low-skilled workers introduced in Botswana, noting the complexities of substitution possibilities in designing an appropriate subsidy rate.

pay can reduce costly labor turnover, may induce worker effort to retain a well-paid post, or enhance the quality of the applicant pool.[61] Testing these propositions has proved elusive, although there is some evidence consistent with their importance.[62] For instance, the observation that multinational enterprises often pay higher wages than do local counterparts is sometimes attributed to the difficulties that multinationals encounter in evaluating local workers, and hence a concern to attract a higher quality pool of applicants.

If wages are kept high by concerns of employers to induce efficient behavior, any attempt to lower such wages may not enhance labor efficiency. The case is much clearer when collective bargaining is the main force behind the wage gap between the formal and informal sectors. This has recently attracted particular attention in the context of South Africa, which has one of the highest unionization rates among the developing economies. The premium earned by male union members in South Africa—even compared with other men with regular wage jobs and similar age and education—has risen very substantially even as overall unemployment has continued to be a severe problem.[63] Nonetheless, the policy options open to address this issue are circumscribed in a democratic society, short of building a social compact of wage restraint, in return for job creation.

Certainly, there are many contexts in which substantial gaps between formal and informal wages persist despite limited, or even restricted, collective bargaining.[64] Some aspects of these high labor costs may be readily amenable to policy change, being policy induced in the first place. For example, the incidence of a payroll or income tax may serve to increase labor costs in covered sectors, while other sectors are exempt from such taxes. Similarly, job security regulations, mandating severance pay or restricting worker dismissals, effectively raise the cost of labor in covered sectors.[65]

In some contexts, public sector pay policies also play a major role in keeping formal sector pay levels high, both directly and by inducing job search for high-paying, public sector posts. This has been a major concern in much of sub-Saharan Africa, for instance. However, Jamal and Weeks (1993) argue that the extent of the gap was probably overstated and that for some African countries the structural adjustments of the 1980s may have reduced urban wages below the earnings of farmers. Either way, as Richard Freeman notes, "Even if this overstates the case, it is clear that by the 1990's the problem in many (African) countries was not that public-sector pay was too high, but that it was too low for the state effectively to provide law-and-order, property protection, and related public activities."[66] Again, there arise

[61] Weiss (1990) reviews these and several other versions, noting the dangers of attempting policy intervention to improve on the choices by employers.

[62] Riveros and Bouton (1994) express skepticism about most of the evidence on efficiency wages in developing countries or elsewhere. However, Velenchik (1997) uses rare, matched, employer-employee data to examine efficiency wage issues in Zimbabwe and finds some support for these arguments.

[63] For evidence, see Moll (1993), Schultz and Mwabu (1998), Butcher and Rouse (2001), Hofmeyr and Lucas (2001).

[64] See Lucas and Verry (1999) on the Malaysian labor market.

[65] Fallon and Lucas (1993) show that such regulations have substantially reduced the use of labor in the formal, covered sectors in India and Zimbabwe.

[66] Freeman (1993, p.404).

efficiency concerns in simply lowering public sector pay, which can decrease the quality of personnel and induce corruption.

Efforts to lower labor costs, especially in the formal sectors, can enhance the efficiency of labor use, with the proviso that lower costs do not lower the quality of workers or lower worker effort. But do lower labor costs also reduce poverty? At least three aspects warrant emphasis. First, enhancing efficiency permits more rapid overall growth, at least in the transition. In turn, broad-based growth does alleviate poverty, although its effectiveness in doing so is limited where initial inequality is very high. Second, an issue arises if job creation in the formal sector proves insensitive to the cost of labor because lower wages could mean a lower total wage bill; if some of this wage bill is transferred to poorer members of the worker's extended family, lowering wages may create only a few additional jobs while lowering the amounts of transfers.[67] Third, where job creation (and especially unskilled job creation) proves more responsive to wage restraint, the resultant incomes from the additional employment can be critical to poverty reduction, provided that the poor can participate either directly through additional hiring or through the trickle-down process.

EDUCATION

Expansion of basic educational opportunities is uniformly viewed as part of a virtuous circle of poverty reduction; basic education accelerates growth while reducing inequality, and in turn, lower inequality further stimulates growth.[68]

One difficulty in identifying the effect of education on growth is that the causation between the two presumably goes both ways: educational expansion stimulates growth, and rising incomes lead to additional demands for education. Much of the cross-country growth analysis attempts to by-pass this difficulty by examining the connection between the level of education at the beginning of the period of observation and subsequent growth. This solution is not entirely satisfactory, if only because the prospect of future growth may have stimulated the initial education. Nonetheless, there is clear agreement that the historical record includes a significant positive association between initial education and subsequent growth.[69] Moreover, unlike many of the correlates of cross-country growth that have been explored in this extensive literature, the positive role of initial education is relatively robust to inclusion of additional explanatory terms.[70] There is, perhaps, less agreement about whether initial

[67] This debate has arisen in the context of a potential social contract in South Africa. See Fallon and Lucas (1998).

[68] See Birdsall, Ross, and Sabot (1995) for an account of these 'virtuous circles' in East Asia.

[69] Robert Barro has been one of the leading contributors to this line of analysis. See, for instance, Barro (1999).

[70] See Levine and Renelt (1992). It does have to be borne in mind that even such robustness of statistical results does not mean that more education pays off without limit. It may be that a high level of education for a given level of per capita income (defined in the equations as high initial education) may be proxy for some sort of economic underperformance in the preceding period and hence for countries with better growth chances (for example, growing out of a trough) independent of their current level of education. It may also be that higher initial education pays off only up to a certain degree beyond the norm for a given per capita income but that this is not picked up in the regressions because too few (or perhaps no) countries have reached initial educational levels far above the norm.

primary or secondary education is more closely associated with subsequent growth, although most contributors agree that it is these basic levels of education that matter.[71]

Whether educational expansion also leads to a more equal distribution of income depends very much on the nature of this expansion. An expansion to continue the upper secondary or college education of an elite few is unlikely to generate greater equality. Thus, Knight and Sabot (1983) argue that an initial expansion in the educational system is likely to prove elitist, leading to increased inequality, whereas further expansion will become more broad based, dissipating the rents of the elite, and equality will again increase. A Kuznets-type curve is traced. Barro (1999) estimates, from his sample of combined cross-country and time varying data, that each additional year of primary schooling on average among the adult population lowers the Gini coefficient by about 1.5 percentage points. Additional years of secondary schooling are estimated by Barro to reduce inequality by less, and this estimate is statistically weak. Moreover, each additional year of higher education actually tends to raise the Gini coefficient by some 7 to 8 percentage points. It seems likely that these relative effects would differ at different stages of development, but this remains unexplored at this time. In contrast, once Barro turns to look at the effects of changes in educational attainment within countries, the effects of additional primary and secondary schooling in diminishing inequality are much smaller and both are statistically weak, although the association between higher education and greater equality remains both positive and statistically significant.

The finding that expansion in higher education tends to result in greater inequality is not too surprising, given the evidence that in both developing and higher income countries it is the children of the wealthy elite who attend college.[72] If expansion in basic education accelerates overall growth and may diminish inequality, it is also not surprising that such an expansion would accelerate growth and the incomes of the poor. In a cross-section of 43 countries (Birdsall and Londono [1997]), growth in incomes of the poorest was higher where average initial education levels were greater and where initial educational inequality was less.[73]

As Gaurav Datt and Martin Ravallion conclude, "The need to combine human resource development with economy-wide policies favorable to growth has been well recognized in discussions of policies for fighting poverty....The key message emerging from recent research is that achieving a policy environment conducive to growth interacts multiplicatively with human resource development. By doing just economic reform or just human resource development, one may achieve very little in terms of poverty reduction, but doing both can take a nation a long way."[74]

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[71] Birdsall and Londono (1997) also indicate that greater equality in initial educational achievement, and not merely its average level, positively affects growth although the authors do not tell us how inequality in education is measured.

[72] On the case of Malaysia, see Lucas and Verry (1999).

[73] In a very recent IMF working paper, Ghura, Leite, and Tsangarides (2002) describe educational achievement as one of the super pro-poor policies that affect income of the lowest quintile within each country, given overall income level or its growth. However, it is unclear how this conclusion is reached; the measure of secondary schooling proves statistically irrelevant, and primary schooling is estimated to lower incomes of the poorest significantly in Table 1. This may, in part, be the result of having included the Gini coefficient as a separate explanatory variable in the analysis, rendering the meaning of the results rather opaque.

[74] Datt and Ravallion (2002) p.105.

HEALTH

The importance of human capital to economic growth and poverty reduction has, for more than a decade, received an enormous amount of attention by both academics and policymakers alike. However, the focus has been on education, while health, the other cornerstone of human capital, has largely been ignored. Health, of course, has value in and of itself: good health is an end that economic development strives to achieve. But it is also the basis of human productivity and thus fundamental to economic development and growth. In contrast, ill health may also be a significant obstacle to both. Indeed, studies have found that body size is related to nutritional levels and this in turn has a significant and positive impact on long-term labor productivity (Fogel 2000, Strauss and Thomas 1998). Further, several studies have found that there is a positive correlation between better health and higher economic growth (Barro and Sala-i-Martin 1995; Bhargava et al. 2001, WHO 2001). Finally, a recent study by Bloom and Sachs (1998) demonstrated that disease burden, demography, and geography, rather than macroeconomic policy and governance, explained more than half of the difference between Africa's growth rates and those of East Asia.

The relationship between health and poverty can be characterized as circular: ill health contributes to poverty and poverty contributes to ill health. A study by Behrman and Deolalikar (1988) provides evidence that the poorest are typically in worse health than other members of society. Further, a number of studies have shown that a wide gap exists between health status of the relatively poor and the relatively better off in a country (Claeson et al. 2001, Gwatkin 2000 in WHO 2001). Given the vulnerability of the poor, ill health has a disproportionately negative effect on their welfare. If this vicious poverty-health circle is to be broken, policymakers must redouble their efforts in the area of health, focusing on improving the poor's access to essential health services[75] and controlling communicable diseases.

Communicable diseases such as malaria, tuberculosis, HIV/AIDS, childhood infectious diseases, tobacco-related illnesses, and micronutrient deficiencies are the main causes of avoidable deaths in low-income countries. These very diseases are not only relatively easily detected but they are also highly treatable. Nonetheless, they continue to contribute to the high mortality rates in developing countries because of the lack of capacity in the public health sector, lack of focus of government health programs, insufficient rural coverage of health care system, and corruption (WHO 2001). In addition, investments in reproductive health and family planning have been shown to translate into reduced fertility rates (Population Reference Bureau, 1999, demographic and health surveys, reproductive health surveys, and other comparable surveys, 1990-1998) and higher investments in child health and education. Overcoming the problems related to combating communicable diseases and improving the health of the poor in developing countries will contribute to pro-poor growth.

Decentralization of the health care system has been on the agenda in Latin America for well over two decades and in Africa since the mid-1980s. Among its purported benefits are improved performance of the primary health care system, increased equity in service

[75] There is some debate regarding whether there should be a focus on preventive care or curative health care..

provision, and increased competition and efficiency in service delivery. According to the World Health Organization (1997), there is no clear evidence that decentralization has improved equity or primary health care delivery. Gilson and Mills (1995) report that in Sub-Saharan Africa between 1985 and 1995 the impact of decentralization on efficiency has been negligible and its impact on equity has been negative. They suggest that two factors contributed to this outcome: (1) conflicting local and central government goals; and (2) weak central planning capacity. In the case of Latin America, a study by the World Bank (1999) points out that the impact of decentralization on equity, efficiency, costs, and quality of care has not been systematically documented. Nonetheless, this study highlights that various countries have reported an increase in service coverage (especially in primary health care); an increase in the fiscal burden; a more complicated and thus less efficient referral system; and a system in which no one, except for the national government, is fully accountable for the quality and quantity of service provision. As mentioned later, Burki, Perry, and Dillinger (1999) ultimately conclude that decentralization has harmed health care service delivery in Latin America

ACCESS TO LAND

Several studies have reported growth and inequality benefits from a more equal distribution of land. For example, Birdsall and Londono (1997) report on the basis of a 43-country sample that a more equal distribution of both land and human capital contributes to growth and poverty reduction.[76] Deininger and Feder (1999) maintain that because access to land in rural areas allows rural poor to "make productive use of family labor, improve their nutritional status, smooth consumption, and improve their income and well-being" it may be an important factor contributing to poverty reduction (Deininger and Feder 1999).

The literature has identified three main channels through which a more egalitarian distribution of land assets can impact growth and poverty reduction. First, access to land allows for households to produce their own subsistence crops, thereby contributing to the food security and nutritional well-being of the family and providing the family with a safety net. Second, land ownership provides the poor with incentives to invest and the collateral needed to access credit markets. It thereby helps them escape the "poverty trap"—the inability to emerge from poverty because they cannot raise their capital stock. Finally, cross-sectional data have confirmed an inverse farm-size productivity relationship whereby family-operated farms are more efficient than those that rely on wage labor (Berry and Cline 1973, Carter 1984, Benjamin 1995, Newell et al. 1997).[77]

[76] The question of the impact of asset inequality on growth is highly contested. The findings of a recent study by Deininger and Olinto (2000) have called into question the concern regarding the negative impact of income inequality on growth. Deininger and Olinto's study found that asset (land) inequality, not income inequality, has a relatively large negative impact on growth. The policy implication of this finding is that asset (land) accumulation by the poor should be facilitated. However, a paper by Lopez and Valdez (2000) reported the opposite findings—namely, that land access was not closely correlated with income at the family level in rural areas.

[77] This has been found to hold true for all but the smallest farm sizes. Nonetheless, imperfections in other markets, such as credit and input markets which disadvantage small farmers, may offset the supervision cost advantage of small family farms.

There is evidence that redistributive land reform helps reduce poverty, increase efficiency, and establish the basis for sustained economic growth when properly implemented. A study of land reforms in India by Besley and Burgess (1998) found that land reforms had a positive poverty impact. In Brazil, land reform is estimated to have increased the incomes of beneficiaries by up to five-fold (Buinainain et al. 1998 in Deininger and Binswanger 1999). The successful experience of the Asian land reforms provides further support for land reform.

Despite its conceptual appeal and such experiences as those just cited, land reform's track record has been mixed. This is in part because land reform is by nature a political process. Many efforts at implementing such reform are motivated by the worthy goals of poverty reduction and increased efficiency, but the process itself generates political obstacles that often frustrate those goals. In other cases, the reforms are motivated mainly by political objectives from the start, rendering poverty reduction and increased efficiency as secondary goals; this is true of numerous land reform programs in Africa and Latin America. Indeed, Deininger and Binswanger (1999) report that most of the land reform programs of the last two to three decades have been "politically motivated and have not lived up to expectations" (p. 249). It is important to note that, to the extent that land reforms have been large enough to potentially have an impact on distribution and have avoided being extremely politicized, the results have been at least fairly good. For example, the land reforms in Bolivia and Mexico, although less famous than those of East Asia, generally had desirable redistributive effects (Eckstein et al. 1978).

Reaping the potential benefits an improved distribution of land can provide requires ensuring that the political involvement of societal forces in favor of the reforms is high relative to those against the reform and ensuring that control rights after the reform are secure and stable. If they are not, beneficiaries will lack the incentive to invest and accumulate. It must be noted, however, that the key is not necessarily ownership but control over resources. Providing formal property rights is neither necessary nor appropriate in all circumstances; other local institutions for conferring control over the resource in question sometimes provide a more optimal solution (Rodrik 1999).

Even if increased access to land holds the promise of being socially and economically beneficial, there is still debate surrounding the most effective mechanism for redistributing land to the poor. The numerous models of land redistribution include (1) expropriation of private farms (usually with some compensation); (2) privatization of state land (grant-assisted and non-grant assisted); (3) auctioning off of land owned by bankrupt enterprises; (4) subsidized purchases by small farmers in the land market. The second, third, and fourth models represent market-friendly modes of redistributing land. The World Bank has recently pointed out that it has been difficult to achieve success in land reform programs that are government directed (model 1). Instead, more market-friendly non-coercive models of land reform are considered to be a "lower cost method to provide efficiency and equity-enhancing redistribution of assets in developing countries" (World Bank 1999). This option is looked on with some optimism by Deininger (1999) but doubted by authors like Lipton (1993).

Further complicating the picture, recent research and empirical evidence have shown that there are certain circumstances (that is, low population density) where communal property rights, rather than individual property rights, are more efficient (World Bank 1999). Additionally, the once-maligned land rental markets are increasingly seen as a possible means for providing some of the poor with access to land. This is especially important given the findings of Carter and Zimmerman (2001) regarding the difficulty of redistribution of land to poor and landless producers through the market. Their conclusion is that redistribution of land to the poor through the market will either not happen or, if it does, it will be slow. This stems in part from the fact that the price of land will exceed "the discounted present value of the income stream that can be produced from production on this land" (Carter and Zimmerman 2001).

INSTITUTIONS[78]

By the 1990s, it became apparent that the orthodox neo-classical approach to development, which focused on "getting prices right," had overlooked the importance of the institutional foundation of market economies. In the late 1970s, the academic literature focusing on institutions, dubbed New Institutional Economics (NIE), began drawing attention to the importance of institutions such as property rights, systems of land tenure, and legal systems in explaining market failures. A vast literature exists on the role of institutions as they relate to economic development (North 1990, Olson 1965, 1982, Nabli et al. 1989). Indeed, the recently published paper by Easterly and Levine, entitled "Tropics, Germs and Crops: How Endowments Influence Economic Development" (2002) is emblematic of this vein of the NIE literature. In this paper, Easterly and Levine find that not only do institutions matter for development, but they also matter more than geography and policy. Indeed, they find that, in the absence of institutions, geography is inconsequential. Finally, contrary to conventional wisdom, Easterly and Levine find that policy does not have much of an impact on development and growth.[79] This latter finding is certain to spark much debate.

Given the plethora of studies examining the impact of institutions on development and growth, to say that institutions matter to economic growth and development is to state the obvious. Currently, the most pressing questions are: What institutions matter for growth? How can they be acquired?[80] Rodrik (1999) argues that those institutions that matter most for growth perform regulatory, stabilizing, and legitimating functions. According to him, the following five types of institutions are needed to for an economy to experience high-quality growth: property and/or control rights, institutions for social insurance, institutions for conflict management, institutions for macroeconomic stabilization, and regulatory institutions. The first three types are particularly relevant for achieving pro-poor growth. In addition, improved public administration is important for achieving pro-poor growth because weak public administrations serve as an obstacle to providing the poor with access to quality education and health care (World Bank 1999).

[78] Although, the NIE literature does not explicitly examine the relationship between institutions and pro-poor growth, the implications of institutions for such growth can be extrapolated from the existing literature.
[79] By "policy" Easterly and Levine refer to national economic policies such as macroeconomic, trade, and capital account policies.
[80] Dani Rodrik's 1999 paper entitled, "Institutions for High-Quality Growth: What are they and how to acquire them?" examines precisely these questions.

The appropriate institutional arrangements vary by country. Indeed, Rodrik argues that best practice "blueprints" should not be overemphasized at the expense of using a strategy of institution building that relies on "local knowledge." Employing local knowledge effectively requires the existence of participatory and decentralized political systems. Because democracies provide greater predictability and stability, they are better at managing shocks, produce better distributional outcomes, and facilitate high quality growth (p.34).

MICROFINANCE AND SMALL ENTERPRISES

At its most fundamental, microfinance is a mechanism to link poor people who are traditionally excluded from financial services to reasonably priced capital and safe savings. Microfinance enhances the ongoing or new economic activities of the poor, generally called microenterprises. The literature on the "economic development value" of microfinance focuses on its role in household poverty reduction rather than on the larger process of economic growth. It also focuses predominately on the "standard" microcredit product, defined by small, group-based, step-wise loans to poor women entrepreneurs.

Within this discussion of poverty reduction and microcredit, a debate emerged in the mid-1990s on household-level economic growth as a result of microcredit. This debate (fueled by Hulme, Mosley, and Morduch, among others) challenged the previously held assumptions that microcredit led to significant economic improvements for participating microentrepreneurs. As a result of conflicting empirical evidence on this point, recent studies have emphasized the impact of microcredit on income diversification, income smoothing, crisis management, household asset building (usually savings), and women's empowerment (Zaman 1999 and the USAID AIMS papers), all areas where there is consensus on the positive role of microcredit.

Although microcredit may be a sound mechanism for reducing poor entrepreneurs' vulnerability, it is unclear if it links the poor to the process of economic growth. The literature examining microfinance does not provide such a tool, perhaps because little attention has been paid to individual lending programs that target the "slightly-less-poor" and that may have greater potential to participate in the economic growth process. In addition, regardless of the type of microcredit examined, other barriers are noted in the literature that keep microcredit from providing a macro-level economic growth tool. As noted by the United Nations Secretary General in his "1998 Report on the Role of Microcredit," the microcredit intervention is inherently limited in macroeconomic development impact because of administrative difficulties, legal constraints, limited ability to overcome market and information barriers, and limited scale in delivery of services. This is not to suggest that the microenterprise sector does not play a significant role in the economy and growth—rather the report points to the limits of the microcredit interventions to enhance that role and that growth. Unfortunately, within this list of microcredit limitations, there is no consensus about which is most binding, although many experts point to market barriers facing microentrepreneurs as the critical factor limiting the economic growth value of microcredit.

Other literature outside the standard microfinance arena point to a broader theme: the relationship among the small-scale sector, the larger financial services market, and economic growth. The 1980s literature from the World Bank and USAID (Little, Mazumdar, and Page 1987; Cortes, Berry, and Ishaq 1987; and Chuta and Liedholm 1985) highlighted the important role of micro, small, and medium-sized enterprises in efficient and broad-based economic growth. Although most of these slightly larger enterprises may be owned and run by the less poor or even the non-poor, they employ the poor and serve as the training ground for successful future microentrepreneurs. Coupling this empirical literature with the literature on financial systems development provides an intellectual link between finance and pro-poor economic growth: a functioning, responsive, accessible financial sector that is able to intermediate between savers and borrowers of all sizes plays an essential role in efficient, broad-based economic growth.[81] Such a system, for example, would allow the necessary capital to reach micro, small, and medium-sized enterprises or the rural agricultural sector in efficient ways. Availability of efficient financial services to the agricultural sector is particularly important because these services fuel a sector providing livelihoods for large numbers of the poor, both in on-farm and off-farm activities. This broad literature on financial sector reform—within which microfinance is an important component—provides a clearer policy window on pro-poor economic growth through financial sector interventions.

ENVIRONMENTAL POLICY

The relationship between environmental policy and pro-poor growth is complex. Approximately three-fourths of the world's poor live in rural areas and are disproportionately dependent on natural resources. The level of dependence of the poor on natural resources varies within and among countries and regions. A widely cited survey of 197 households and 29 villages in Zimbabwe found that the value of the "environmental resources" used by rural households was equivalent to 35 percent of the poor's average total income (Cavendish 1999).[82] Because this value is not registered as income, neither improvements in the rural poor's situation nor deterioration is properly registered. Ignoring the value of these resources to a rural household altogether may provide a distorted picture of rural poor welfare.

Since the poor are dependent on natural resources, environmental policies can have a significant impact on the poor and pro-poor growth. The literature highlights at least two ways by which environmental policy can positively impact pro-poor growth. These are (1) by enhancing the poor's opportunities; and (2) by increasing their capacity.

Access to common resources to the livelihood of the rural poor is key to enhancing their opportunities (Bucknall, Kraus, and Pillai 2000). As such, systems of natural resource

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[81] See Von Pischke et al. 1983.

[82] By "environmental income" Cavendish refers to the value derived from wild resources that are characterized as being "renewable, occurring spontaneously, and often held under communal tenure." For example, environmental income can be derived from wild foods (but not from cultivated agricultural products); wild medicines; wood used for timber, fuel, etc.; grasses, canes, and reeds for thatch, mats, and baskets; and livestock fodder and water. "As a result, this considerable set of resources …are effectively provided free to the household – what might be termed the 'supermarket of the wild'" (Cavendish 1999, p.1).

management, including property rights and local institutions for the management of commons, are central to the issue of pro-poor growth. In urban areas, tenure security over the land inhabited by the poor is critical. In the absence of an appropriate system for granting access to commons and tenure security, incentives for properly managing resources are significantly reduced. That is not to say that common resources should be privatized; ownership is not the point, rather control over resources is what is important. Ultimately, solutions should be context specific and local institutions for managing natural resources should be considered as possible alternatives to conferring formal property rights through privatization.

Environmental policies that use incentives to promote resource conservation in areas where the poor live not only achieve conservation but also provide increased opportunities for the poor. For example, those policies that promote conservation farming simultaneously enhance the opportunities for the poor as farmers and contribute to the conservation of resources.

Both rural and urban poor are exposed to environmental threats to their health. For example, a large percentage of the urban poor live in slums that lack access to basic services such as clean water, sanitation, and waste disposal, and because the urban poor spend more time outdoors than others they are exposed to air pollution. As a consequence, they are at greater risk of exposure to air- and water-borne diseases. Policies that minimize these risks have a positive impact on the health of the poor and thereby increase their capacity to engage in economically productive activities.

It is important to recognize that the poor are not only victims of environmental degradation, but at times they also can become its agents. Indeed, Deininger and Minten (1999) report that smallholders' need for agricultural land resulted in massive deforestation in Mexico. Environmental policies must seek to avoid both victimizing the poor and facilitating their degradation of natural resources.

Finally, because of their dependence on communal resources (that is, they collect fodder, fuel, and water), rural poor women are disproportionately affected by environmental degradation. Agarwal (1997) posits that women can be more severely affected in at least six ways: time, income, nutrition, health, social support networks, and knowledge systems. In addition, it has been shown that women have a varied and complex relationship to the environment: they are both victims and caretakers (Leach 1994 in Bucknall, Kraus, and Pillai 2000). It is therefore important to recognize the gender dimension of environmental policy. Given the role of women as caretakers of natural resources and their relationship to natural resources, oftentimes women are the most receptive to participating in resource conservation projects and are willing to act as intermediaries between the household and the project implementers.

CHAPTER FIVE
SOCIAL SAFETY NETS AND TRANSIENT VERSUS CHRONIC POVERTY

So far, this review has focused upon long-term strategies for poverty alleviation. Superimposed on this are the many, often short-lived, crises that affect families in poor countries. At least three, very broad categories of crises may be distinguished. The first arises from macro-economic fluctuations, such as the East Asia and Tequila crises or the effect of structural adjustments in the 1980s. A second group of crises arise from natural disasters or violence. Third, individual families or communities may suffer from more idiosyncratic crises, induced by such factors as illness, death, or loss of employment. Although these types of crises differ in fundamental ways, they also exhibit key features in common. Particular crises, of whatever ilk, add to poverty.

Do chronic and transient poverty differ? Jalan and Ravallion (2000) examine the correlates of these two aspects of poverty using household level consumption data from four provinces of southwest China during 1985-1990. Transient poverty is defined in this study as that part of poverty that results from fluctuations in household consumption; chronic poverty is the remaining part, after fluctuations in consumption have been smoothed out.[83] Among the four provinces studied, the contribution of transient to total poverty ranges from nearly 43 percent in Guizhou to over 84 percent in Guangdong. The authors conclude that "Commonly identified causes of poverty....have weak explanatory power for transient poverty and some of the factors determining transient poverty do not matter to chronic poverty, or even have the opposite effect. Successful policy responses to chronic poverty may still leave considerable transient poverty."[84] For example, the Jalan-Ravallion study finds that such factors as education levels of the household and crop yields are more relevant to chronic poverty than to transient poverty.

Transient poverty can also instigate chronic poverty. For instance, if loss of family income results in declining nutrition, health, or education of their children, the long-term capacity to earn may be adversely affected. The ability of families to protect their consumption levels, and especially those of their children, during crises has been the subject of a good deal of literature during the last decade or so. Much depends upon how the family responds as well as upon the nature of any public safety nets in place.

FAMILY AND COMMUNITY RESPONSES TO CRISES

In principle, a number of mechanisms may enable families to smooth their consumption in the face of a shock to their incomes. Among the more important of these are the liquidation of family assets, borrowing or transfers from the extended family or wider community, and adjusting family labor supply. A consensus seems to have emerged that the average family in

[83] A clear difficulty in examining these distinctions, in any context, is that errors in measuring household consumption across time periods may tend to add to perceptions of transient poverty.
[84] Jalan and Ravallion (2000) p.82.

the developing countries does not need to cut its consumption by the full extent of any transitory loss in income, as a result of the combined effect of such adjustment mechanisms, although the ability to insure is far from complete.[85]

Moreover, the first two mechanisms mentioned above—liquidating assets and ability to borrow—are more accessible to the relatively wealthy, and poorer households prove less able to protect themselves against income fluctuations. For poorer households, the main mechanism of adjustment in times of special hardship is through adjustments to their labor supply. This may involve increased labor force participation to offset lower earnings of other family members, migration for employment, or simply switching jobs. For instance, during the 1998 crisis in Indonesia, employment levels actually increased because labor force participation of women expanded and massive migration occurred from urban to rural areas and agricultural employment expanded, while other sectors declined.[86] Indeed, during the major financial crises in the 1990s labor markets proved remarkably responsive, in terms of labor supply and in the ability to generate jobs in sectors stimulated by depreciating exchange rates. Where exchange rate cuts were deepest, real wages fell the most; where real wages fell the most, relative to the decline in GDP, the rise in unemployment was least.[87] Similarly, it seems this trade-off between wage flexibility and unemployment played an important role in the income distributional effects of the adjustment crises of the 1980s. Thus, Bourguignon, de Melo, and Suwa (1991) find, from simulations, that "in the standard adjustment package, inequality increased significantly for the Latin American archetype but decreased significantly for the African archetype."[88] The greater formal sector real wage rigidity, and hence higher unemployment in the Latin American archetype, exacerbate inequality in these simulations; in contrast, the incentives provided to agriculture by a depreciating exchange rate, combined with dependence of the poor on agriculture in the African archetype, narrows income inequalities.

No matter how flexible the labor markets, in the end poorer households are forced to cut their consumption levels during crises that shock their incomes. The extent to which this results in longer-term poverty impacts through poorer nutrition and loss of schooling for children still depends upon how the family makes internal adjustments. Do parents bear the brunt of shocks in poor households, leaving children unharmed? The answer appears to vary by context. The limited evidence on the extent to which children drop out of school during crises is mixed. During the 1998 crisis in Indonesia, enrollment rates declined and drop-out rates increased among children ages 7-12 and even more so among youths ages 13-19, with little difference between the genders.[89] In contrast, Lustig (1998) notes that during the 1982 crisis in Mexico, although drop-out rates from high school increased in line with the longer term trend, dropping out of primary school actually decreased. Even where drop-out rates do rise during a crisis, it remains unclear whether these withdrawals prove permanent or if pupils

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[85] For surveys, see Alderman and Paxson (1994), Morduch (1995), and Townsend (1995). Much of this evidence refers to sharing within villages, although Grimard (1997) presents evidence of consumption smoothing through income sharing among a wider ethnic community in Côte d'Ivoire.
[86] See Smith, Thomas, Frankenberg, Beegle, and Teruel (1999).
[87] See the cross-country evidence in Fallon and Lucas (2002).
[88] Bourguignon, de Melo, and Suwa (1991), p.359.
[89] Frankenberg, Thomas, and Beegle (1999).

later return to continue their education, although both dropping out temporarily and postponing entry can impose significant costs on life-time earnings.[90] Evidence on nutritional impacts on children during crises is also mixed. Anthropometric measures, taken before and just after the Indonesia crisis in 1998, indicate no significant loss in weight-for-height of children, although the body mass index of adults decreased (either reflecting reduced nutritional intake or increased energy output at work).[91] However, Foster (1995) reports significant weight loss among village children in Bangladesh following the 1988 floods, especially among children of poorer families. Carter and Maluccio (2002) also find negative impacts on children's nutrition by making interesting use of South African panel data on households. In these data, each family is asked whether it has been impacted by various types of shock and when these shocks occurred. The authors note that height of children is strongly influenced by nutrition during the prenatal stage through age 3. Children from families hit by crises during this age period are estimated to suffer significantly greater stunting than are other children from the same families. Carter and Maluccio also find that, when other families in the same geographic community are simultaneously hurt by a crisis, the ability of an individual family to mitigate the effects of any shock on its own child's height is diminished.

In sum, families, extended families, and wider communities do offer important mechanisms to insure smoother consumption and to avoid long-term harm to children during crises. However, on average the extent of insurance is far from complete and especially so among poorer families and when the wider community itself is impacted. This suggests an important role for public safety nets during crises.

PUBLIC SAFETY NETS

Public safety nets, existing across the developing and transition economies, take many forms. Transfers may be in cash (unemployment benefits) or in kind (emergency relief). Eligibility criteria may be defined by willingness to work (public works), by age (pension schemes), or by some proxy for means testing (such as the ownership of land or regional targeting). Whatever the form, two key aspects of any program and its design dominate cost-effectiveness: the ability to target the poor, and the difficulty of monitoring and administering the program.

Most of the transition economies introduced unemployment benefits after 1990. The difficulties of monitoring these schemes rapidly became apparent, where the administrative capacity to discern the employed from the unemployed was weak.[92] Moreover, unemployment insurance provides a disincentive to return to employment. As a result, unemployment benefit schemes are rare in the lower-income economies. However, a number of South American countries have, recently, introduced unemployment insurance savings

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[90] See Jacoby (1994) and Glewwe and Jacoby (1995).
[91] Frankenberg, Thomas, and Beegle (1999). This is also broadly supported in Bhargava (1997) with evidence from Rwanda.
[92] For a more general discussion, see Barr (1994).

accounts schemes, although these schemes seem to lack even the advantage of risk pooling offered by the unemployment benefits in the OECD countries.[93]

In the lower-income countries, some programs have attempted to target the poor by defining eligibility on being landless, on a regional basis, or by age.[94] However, the costs of such programs can become prohibitive when the correlation between the eligibility criterion and poverty is weak. Moreover, in cases where the eligibility criterion can be disguised or affected by the program, which can be true of land holding, the ability to target is again diminished.

Subbarao et al. (1997) attempt a cross-country review of the cost-effectiveness of safety net programs in several low- and middle-income countries. Their estimates suggest a very wide range of effectiveness in reaching the poor. For example, the proportion of cash transfers reaching the poor in Eastern Europe are reported to range from 20 to 60 percent; similarly, some 20 to 70 percent of food aid is estimated to reach the poor in low-income countries.

In comparison with other forms of public safety nets, public workfare programs are often particularly effective in targeting the poor.[95] Provided that wages offered by workfare are kept sufficiently low, relative to local alternatives, such programs are effectively self-targeting. Only the poor will be willing to accept low wage, workfare jobs. Ravallion (1991) examines the consequences for the Maharashtra Employment Guarantee Scheme of a 1988 wage increase following an increase in the minimum wage, noting that the self-targeting advantages were impaired by subsequent rationing of access to "guaranteed" employment.[96] An appropriate schedule of wage payments is a key element in the design of successful workfare programs.[97] Other key design issues include any eligibility requirements imposed on participant workers and the selection and accessibility of projects. Accessibility is an issue of location of projects in relation to the poor and an issue of timing in relation to variation in other demands on labor. The selection of projects is also important for at least two reasons. First, where public works result in enhanced infrastructure that benefits the poor, the net benefit of such projects in terms of longer-term poverty reduction can be considerable.[98] Second, some public works projects exhibit high non-wage costs, lowering at least the immediate cost-effectiveness of the program. Vodopivec and Raju (2002) also note that

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[93] For a description and evaluation, see Vodopivec and Raju (2002).

[94] See Ravallion and Sen (1994) on land-based targeting in Bangladesh, Ravallion (1993) on regional targeting in Indonesia, and Case and Deaton (1998) on the pension scheme in South Africa.

[95] See Ravallion (1991) on experiences in South Asia, Jalan and Ravallion (1998) on Argentina's Trabajar program. Participation of small farmers in workfare programs in India has been taken by some critics as evidence of benefiting the non-poor, but this fails to recognize that many small farmers are indeed poor.

[96] Datt and Ravallion (1994) also find evidence in support of rationed entry to public works employment in two villages in semi-arid India and that creation of these programs does little to reflect the most pressing existing employment demands. See also, Ravallion, Datt, and Chaudhuri (1993).

[97] Competition from low-wage workfare programs may, however, pose a threat to other workers. This became a basis of concern by organized labor in South Africa.

[98] Ravallion (1999a) sketches some stylized scenarios in which the benefits reaching the poor double where such future gains are realized.

workfare programs have the advantages of being both flexible during shocks and relatively undemanding on administrative capacity.[99]

Whatever the form of safety net deployed, the cost-effectiveness is diminished by the tendency for family and community support to be partially curtailed in response to the creation of public safety nets. Don Cox and Manny Jimenez have examined this trade-off in a series of country analyses, covering Peru, the Philippines, Poland, and Vietnam.[100] Their evidence indicates a significant trade-off but one that is far short of a total offset. This private response to public programs reduces, but far from eliminates, program efficacy.

Workfare programs probably offer one of the best mechanisms of aiding the poor in times of crisis, especially in the lower-income countries. Augmented by support networks of the extended family and even the wider community, the earnings generated reach well beyond those people directly employed. However, some groups may not be reached, either directly or indirectly, through employment creation efforts. In particular, anyone without the capacity to work themselves, and lacking attachment to a social network whose members would benefit from workfare programs, can be reached only through other forms of safety nets. A prime example are the children of southern Africa, where HIV has left entire villages without adults, almost no community safety networks, and utterly dependent on NGO efforts.

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[99] Vodopivec and Raju remark that some programs stigmatize workers, although Galasso, Salvia, and Ravallion (2001) report the reverse in the case of the Argentine Trabajar, where placement in the program seems to carry positive signals for subsequent employers.

[100] Cox and Jimenez (1992, 1995), Cox, Jimenez, and Okrasa (1997).

CHAPTER SIX
VIOLENT CONFLICT, INEQUALITY, AND POVERTY

Practitioners and researchers perceive that socio-economic inequality is among the most important causes of violent conflict. Alesina and Perotti (1996) and Juha Auvinen (1997) perform cross-sectional regressions on empirical data to explore the link between socio-economic inequality and violent conflict. They find that inequality leads to an unstable socio-political environment—and fuels social discontent—which is conducive to violent conflict. Boswell and Dixon (1990) examine the relationship among poor economic performance, income inequality, and violent conflict. Performing cross-sectional analysis of data from 63 countries, they find that low growth rates and high levels of income inequality are central causes of violent conflict (as noted in most social theories, see Lichbach 1989, for a survey of this literature) and that income inequality affects violent conflict risk directly. Nafziger and Auvinen (2002) note that high inequality is associated with violent conflict, particularly when the "less advantaged can identify the perpetuators of their poverty and suffering" as was the case in Nigeria, South Africa, and Chiapas, Mexico. Studies by Nafziger and Auvinen (2002) and Stewart (2000) also find that economic stagnation or decline can lead to violent conflict, particularly when losses are not distributed across all income categories (that is, rising inequality feeds social discontent that gives rise to political violence).

Other researchers dispute the link between inequality and violent conflict and point to poverty as a central determinant of conflict risk (often stated to include lack of economic opportunities). Collier and Hoeffler (1998), using probit and tobit models, analyze data from a sample of 98 countries of which 27 had civil wars of varying length between 1960 and 1992. They conclude that low levels of initial per capita income, inter alia, significantly increase the probability of conflict. Collier (2000), in a subsequent study, argues that neither income nor asset inequality affects conflict risk. Unequal societies, he states, "are not more prone to conflict" (p. 7).

The impact of war on levels of poverty, inequality, and economic growth is widely recognized. Sources that describe the various impacts include Stewart (1997), Cranna (1994), and Pottebaum (2002). Collier's (1999) analysis of cross-national data shows that during civil war annual GDP growth is reduced by 2.2 percent. This implies that a 15-year civil war would reduce per capita GDP by approximately 30 percent.

POST-CONFLICT POLICIES

Getting policies right is particularly important for countries emerging from conflict because these societies face very high risk of returning to violent conflict. Furthermore, there is a great risk that policies will worsen the impact of war on social welfare. A key question for policy makers, then, is, What can be done to reduce these risks? Perhaps most important, policies must recognize that trust is one casualty of war. Policies must address this by creating an environment that changes peoples' expectations and mends torn relations between the state and the public.

Development policies must take account of the links among poverty, inequality, and violent conflict. In a cross-national study of empirical evidence from 62 countries, Collier and Hoeffler (2002) find that post-conflict economic policies should emphasize governance and social development rather than macro-economic issues (see Humphreys 2002, for a review of other research on this topic). They stress that their findings do not mean that macro-economic policies do not matter—simply as a matter of priorities, governance and social policies appear to be more important.

Post-conflict policies should also target the poor and seek to lessen social and economic inequality, including, for example, expanding access to education and health care to the poor and disadvantaged groups. Stewart (2000) stresses that policies must aim to reduce group inequalities and suggests a range of affirmative action interventions. Governments involved should adopt policies that guarantee broad-based political representation and that institutionalize participation by disenfranchised groups in national policy-making.

Uganda has been largely successful in making a transition from war to peace. Since the end of war in 1986, the Ugandan government implemented policies that built a foundation for a peaceful future. Perhaps most important, the government increased educational attainment; built strong democratic institutions, including a free press; increased local decision-making authority; and improved investor confidence. The result has been a substantial reduction in poverty; a growing economy; and, most important of all, a broadly maintained peace (Collier 1999).

CHAPTER SEVEN
HIV/AIDS AND PRO-POOR GROWTH

As of 2002, over 40 million people are estimated to be living with HIV, with over 20 million estimated to have already died of AIDS. Projections for 2010 predict 100 million people living with HIV/AIDS worldwide, with at least 40 million children orphaned by the disease. As the scope of the HIV/AIDS epidemic continues to expand beyond previous worse-case scenarios, its likely impact on poverty and economic growth has emerged as a growing concern of those tracking the epidemic or living with its consequences. Rather surprisingly, however, HIV/AIDS has not yet become a recognized driving force in the development community's broader discussions of poverty and economic growth, which still treats HIV/AIDS as a health issue.

The specialized literature linking HIV/AIDS, poverty, economic growth, and "pro-poor economic growth" can be broken into three main themes: (1) the immediate poverty-increasing impact of HIV/AIDS, (2) the medium-term macro-economic impact of HIV/AIDS, and (3) the longer-term "anti-poor" economic impact of HIV/AIDS.

THE IMMEDIATE POVERTY-INCREASING IMPACT OF HIV/AIDS

HIV/AIDS increases the scale and depth of poverty for sufferers and their families by pushing those already poor deeper into poverty, and by pulling the non-poor into poverty. This unsurprising conclusion is largely based on household-level analysis of the income, asset, investment, and labor patterns of AIDS-affected households, all of which show a downward spiral under the influence of HIV/AIDS. The literature suggests that the poverty-increasing effect of HIV/AIDS falls proportionally more heavily on the poorest as a result of a range of factors: faster disease progression because of inferior initial health and diet; lower ability to manage HIV in such a way as to remain productive after infection; and more pressure to undertake irreversible coping strategies, such as sale of productive assets and land or family dissolution. This literature points policy-makers and programmers toward critical intervention points to avoid irreparable damage to households. It also highlights the need to slow the epidemic to maintain past poverty-reduction achievements.

THE MEDIUM-TERM MACRO-ECONOMIC IMPACT OF HIV/AIDS

Beyond a certain threshold of prevalence, HIV/AIDS reduces economic growth at the sectoral and national level. The literature focuses on considers overall labor and skill availability in wealth-creating and trade-based activities, along with increased costs of training and maintaining a productive labor base. It also examines the overall declines in domestic market demand as a result of AIDS, leading to declines in some of economic activities. World Bank projections suggest that because of HIV/AIDS, total (not per capita) GDP may fall by as much as 25 percent over a 20-year period, based on analyses in

Tanzania, Cameroon, Zambia, Swaziland, Kenya, and elsewhere (see Over, Stover, etc.). Such aggregate level predictions are complemented by sector-specific assessments of the impact of HIV/AIDS, as evidenced by the literature on the insurance industry, agriculture, and microfinance, among others. This literature on overall economic impacts has captured the attention of national and international leaders concerned with economic growth.

THE LONGER-TERM "ANTI-POOR" ECONOMIC IMPACT OF HIV/AIDS

The increasingly disproportionate impact of HIV/AIDS on the poor will lead to increased difficulty for them to participate successfully in remunerative economic activities, such as commercial agriculture and formal sector work. This literature remains fragmented and predictive in nature but is likely to emerge as increasingly central. In particular, the emergence of the next generation of poor with less education, fewer assets, fewer life-skills, lower self-esteem, and a greater sense of isolation and hopelessness because of HIV/AIDS will increase the visibility and importance of this topic over the coming decade. This theme is only now beginning to emerge in the literature (through the work of Malcolm McPherson and others).

The literature is dominated by conceptual frameworks and projection-based models of the economic impacts of HIV/AIDS. Empirical evidence remains sparse, drawing on a few small-sample studies and observations by field-based practitioners. As a result of the nature of the epidemic (where current high HIV prevalence rates will translate into high morbidity and mortality numbers in the next 5-10 years), empirical information should become much more readily available in the coming years but at a point where policy options for response may be narrowed considerably because of the magnitude of the emergency. For this reason, the conceptual and projection-based literature may be particularly useful to policy-makers now, despite the paucity of empirical findings.

CHAPTER EIGHT
SUB-NATIONAL FOCUS: ANOTHER NEW WASHINGTON CONSENSUS?

In Washington, a new component of consensus emphasizes the advantages of decentralized decision making and implementation. Superimposed on this is a distinct geographic pattern to poverty within countries. Together, these raise the question as to whether decentralization better serves the poor.

Within countries, there can be considerable regional variation in poverty levels—Bihar in India and the northeast of Brazil have far higher poverty rates than the corresponding national average. Within regions, there are also localized pockets of poverty, ranging from urban slums to tribal hill villages. Moreover, there is some evidence that these geographic variations in poverty are not merely reflections of differences in such measures as education levels, land ownership, or occupational structure of individuals living in these locations.[101] If migration is insufficient to close this geographic dimension to income gaps, clearly some barriers must exist to mobility. Typically, transport costs are far too low to raise an effective barrier. However, lack of social network contacts in the more prosperous locations and lack of funds to finance job search or necessary education for transition may erect restrictive hurdles.[102] Add to this the fact that social services are normally poorer in poor areas, so education remains substandard in poor locations and the gaps in incomes may readily widen over time.[103]

The impact of decentralization upon the geographic pattern of poverty depends very much upon the nature of decentralization. If each sub-national government is left to depend largely upon local revenues, geographic disparities are likely to be exacerbated. However, an increased relative role for spending by sub-national tiers of government, combined with transfers from the center, may facilitate regional targeting of poverty.[104] Among other advantages often asserted are superior local information possessed by sub-national governments with respect to identifying the poor, the potential for local design of poverty responses, and the ease of monitoring and control by local communities.[105] Whether this greater local control results in capture of projects by a local elite is ambiguous. Bardhan and Mookherjee (2000) argue that, on the one hand, local governments may face more cohesive interest groups and lower levels of voter awareness and of electoral competition; on the other hand, campaign donations may assume a greater value at the national level when they may be directed to the most effective district. Fisman and Gatti (1999) present one of the only systematic investigations of this issue, attempting a cross-country analysis and concluding

[101] See Ravallion and Wodon (1999) on household survey evidence from Bangladesh.
[102] See Lucas (2002a).
[103] Rao (2002).
[104] See, for example, the discussion and evidence on under-funding in poorer areas of Vietnam in Bird, Litvack, and Rao (1995) and the experiences with decentralization in Latin America in Burki, Perry, and Dillinger (1999).
[105] Besley (1997), von Braun and Grote (2000), Bardhan and Mookherjee (2001), Conning and Kevane (2002), and Rao (2002).

that there is significant evidence of a negative correlation between the sub-national share in total government spending and various indices of corruption.[106]

A problem in any decentralized strategy for poverty alleviation is that poor states may prove less pro-poor.[107] This may reflect either an inability of the poorer states to identify and reach the poor or a greater propensity of an elite to capture program benefits in poorer settings. Although there is little hard evidence, some contributors hypothesize that program capture is likely to be greater in conditions of greater inequality.[108] Combined with arguments that corruption increases poverty, doubts arise as to the efficacy of decentralization in benefiting the poor and perhaps especially so where initial inequality is particularly high.[109]

So, do sub-national levels of government prove to be pro-poor? Unfortunately, this is an area with very little evidence. Moreover, even the limited, existing results are mixed. Three types of evidence may be cited. First, country case studies reveal no clear correlation, in either direction, between poverty reduction and decentralization.[110] Burki, Perry, and Dillinger (1999) review the experiences of some of the Latin American countries with various forms of decentralization in health care delivery, education, and roads. They note the difficulties of evaluating value added in schools but conclude that, “Decentralization to subregional governments may...yield some educational benefits by allowing greater innovation and greater flexibility to adapt to local conditions, but they have not yet been demonstrated.”[111] On health care delivery, their message is less ambiguous: “Overall, it might be argued that decentralization has damaged health care provision.”[112] Regarding the second type of evidence, Von Braun and Grote (2000) present a very simple, cross-country tabulation of the proportion of population living on less than $1 a day: the UNDP Human Development Index, the World Health Organization health quality index, and the illiteracy rate. There is little difference in any of these measures among countries with no elections, those that hold elections at the central level, or those that hold elections at the provincial level; only countries with local elections have clearly lower poverty measures and quality of life measures. However, it is unclear what to conclude from this. As the authors note, no controls are allowed for in this simple summary and even the direction of causality might be disputed. Do countries with local elections fight poverty more vigorously, or do countries with less poverty and better education choose local elections? The third set of evidence often cited in

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[106] In this analysis, Fisman and Gatti control for per capita income, size of country, a measure of civil liberties, openness to trade, and the extent of ethnic fractionalization.

[107] Most of the evidence actually refers to poor counties rather than poor provinces of countries. See Ravallion (1999b) footnote 2. However, Ravallion (1998) examines a change in program in Argentina, finding that a higher provincial poverty rate attracted more central spending, but spending of these funds by poor provinces was less discriminating in favor of poor areas within the province.

[108] See Bardhan and Mookherjee (1999) or Von Braun and Grote (2000).

[109] Von Braun and Grote (2000), p.9 summarize the results of work by Gupta, Davoodi, and Alonso-Terme (1998) as showing “that corruption increases income inequality and poverty through channels such as lower growth, regressive taxes, less effective targeting of social programs, unequal access to education, policy biases favoring inequality in asset ownership, reduced social spending, and higher investment risks for the poor.”

[110] Blair (2000) describes the situation in six developing and transition economies, whereas Von Braun and Grote (2000) look at the cases of China, Egypt, Ghana, and India.

[111] Burki, Perry, and Dillinger (1999) p.68.

[112] Burki, Perry, and Dillinger (1999) p.85.

this arena is a finding by Easterly and Kraay (2000) that small countries (with populations below 1 million) have a lower incidence of poverty and somewhat better human development indicators than do larger countries. Yet the issue of whether small countries are more pro-poor would seem distinct in many ways from the issue of whether provinces will prove more pro-poor than a central government.

Neither theoretical arguments nor evidence offers a clear justification for assuming that decentralization will prove pro-poor. Any alignment in these two components within a new Washington consensus would seem premature. The capacity of federal systems or international donors to spend through sub-national agencies may offer advantages in regional targeting, although there are also considerable dangers of greater fiscal irresponsibility among some sub-national governments. Whether these sub-national agencies react in a pro-poor manner is less clear. Perhaps the likelihood of pro-poor implementation is enhanced where local inequality is less and the potential for corruption lower. At least where pro-poor responses are less apparent, the donor has the option of building in incentives to change these responses, withholding funding from agencies that fail to alleviate poverty.

CHAPTER NINE
SUMMING UP

The titles of two Washington publications, appearing in the last two years, are revealing; a World Bank volume entitled *Growth is Good for the Poor* and an IMF Working Paper called "Is Growth Enough?"[113] The evidence demonstrates that, on average, economic expansion does reduce poverty. Even if one looks beyond the averages, in most contexts where growth occurs, poverty falls no matter whether inequality becomes greater or less; in most contexts where production falls, poverty increases. Growth is good for the poor, but is growth enough? The question is ambiguous. There is a good deal of spread in the rates of poverty alleviation across economies exhibiting similar growth rates. Growth is then not enough for maximum poverty alleviation in the sense that it is possible to choose development strategies that are more pro-poor at given growth rates. But whether it is worth sacrificing growth to achieve quick poverty reduction is far more dubious. Indeed, much of our evidence indicates that more unequal societies grow less quickly, although considerable evidence indicates that where initial inequality is high poverty reduction through growth tends to be very slow. This does not argue for reduction of poverty by any means whatever. In fact, even if a historically low level of inequality bodes well for future poverty reduction, that same level of inequality achieved through recent wealth transfers may not. The ideal, for poverty reduction, is therefore to seek policy scenarios that can enhance growth simultaneously while equalizing incomes and opportunities. The choice is a critical one because, if redistributing wealth to the poor comes at the cost of future growth, poverty reduction today may come at the price of greater poverty hereafter.

In broad terms, policy areas can be identified that are able to spread incomes more evenly, while accelerating growth:

- The clearest case, and that most widely recognized in the literature, is for the expansion of basic educational opportunities. The evidence indicates that an expansion in primary and lower secondary school achievement can both accelerate economic growth and narrow income dispersion. Conversely, initial expansion of elitist levels of education, whose definition will vary with levels of development, sharpens income disparities.

- Another clear case is to expand access by the poor to quality primary health care and combat communicable diseases.

- Reducing biases against agricultural competitiveness, including trade policy reforms, may be particularly effective in reaching the rural poor while enhancing overall efficiency. However, in contexts of great disparities within the rural sector, even agricultural growth may do little to alleviate poverty.

- Trade liberalization in the form of removing biases against producing manufactured exports that are intensive in their use of less-skilled workers in low-income countries

[113] Dollar and Kraay (2000) and Ghura, Leite, and Tsangarides (2002), respectively.

directly raises earnings at least of the urban poor. In contrast, growth in industrial production through import protection of capital-intensive industries normally generates few jobs in low-income countries. Without employment creation, any trickle down from industrial expansion to the rural poor is extremely limited. Nonetheless, rapid trade and hence price reform can initially exacerbate unemployment and poverty. This may be especially true where the financial sector is ill equipped to facilitate investments in newly competitive sectors, where the legal and administrative capacity of the country imposes barriers to change, where public enterprises on soft budgets prove unresponsive to prices, or where the intent of the reforms is not politically credible.

- Limiting taxes and labor market regulations that raise labor costs encourages more efficient use of labor and enables trade and other reforms to create jobs.

- A final policy area is to improve the poor's access to credit and land and other natural resources and control over the natural resources.

In addition to the problems associated with chronic poverty, families can also be thrown into poverty during personal or more widely spread crises. It is not clear how often this transient poverty results in longer term indigence, although it has the capacity to do so, particularly through impacts on long-term development of children. At least in the low-income countries, there is mounting evidence of the ability of many families to offset such crises, although only partially, through extended family and community support networks. There is also mounting evidence that poor families receive far less protection than do others, particularly where an entire community is affected. In these instances, given limited administrative capacity and scarce fiscal resources, low wage, public workfare programs seem to offer the most cost-effective resolution. Nonetheless, some communities and individuals may remain untouched by such efforts, either directly or indirectly, and for them other forms of public safety nets become critical.

Lastly, the new Washington consensus—if there is one—has not only swung toward a more explicit concern for poverty reduction but toward a greater fascination with decentralization. A review of the literature reveals little clear evidence, or even arguments, that these two should go hand-in-hand. Perhaps decentralization, to rely more heavily upon sub-national bodies, has other merits, but the case that it proves more effective in poverty reduction remains to be made. This argues that any shift in this direction should be cautious and selective.

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The findings, interpretations, and conclusions expressed in this paper are entirely those of the author. They do not necessrily represent the views of USAID.

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